# Public Utilities

## FORTNIGHTLY

Volume L No. 1 July 3, 1952

RATE MAKING AND INFLATION

*By The Honorable John P. Randolph*

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Natural Gas Supply and Federal Regulation

*By Lyon F. Terry*

« »

Should Fair Return Be Limited to Cost of Money?

*By Ralph E. Badger*

« »

Impact of Price Level Changes on Utility Depreciation Costs Part II.

*By Paul Grady*

« »

INDEX to Volume XLIX included in this issue

UTILITIES REPORTS, INC., PUBLISHERS

ublic Utilities Fortnightly . . nds for Federal and state regu- ion of both privately owned and erated utilities and publicly owned d operated utilities, on a fair and ndiscriminatory basis; for nondis- iminatory administration of laws; r equitable and nondiscriminatory xation; and, in general—for the per- tuation of the free enterprise sys- n. It is an open forum for the free pression of opinion concerning pub- utility regulation and allied topics. is supported by subscription and vertising revenue; it is not the uthpiece of any group or faction; is not under the editorial supervi- n of, nor does it bear the endorse- nt of, any organization or associa- n. The editors do not assume re- nsibility for the opinions expressed its contributors.

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# Public Utilities
## *FORTNIGHTLY*

Volume L — JULY 3, 1952 — Number 1

### Articles



### Feature Sections



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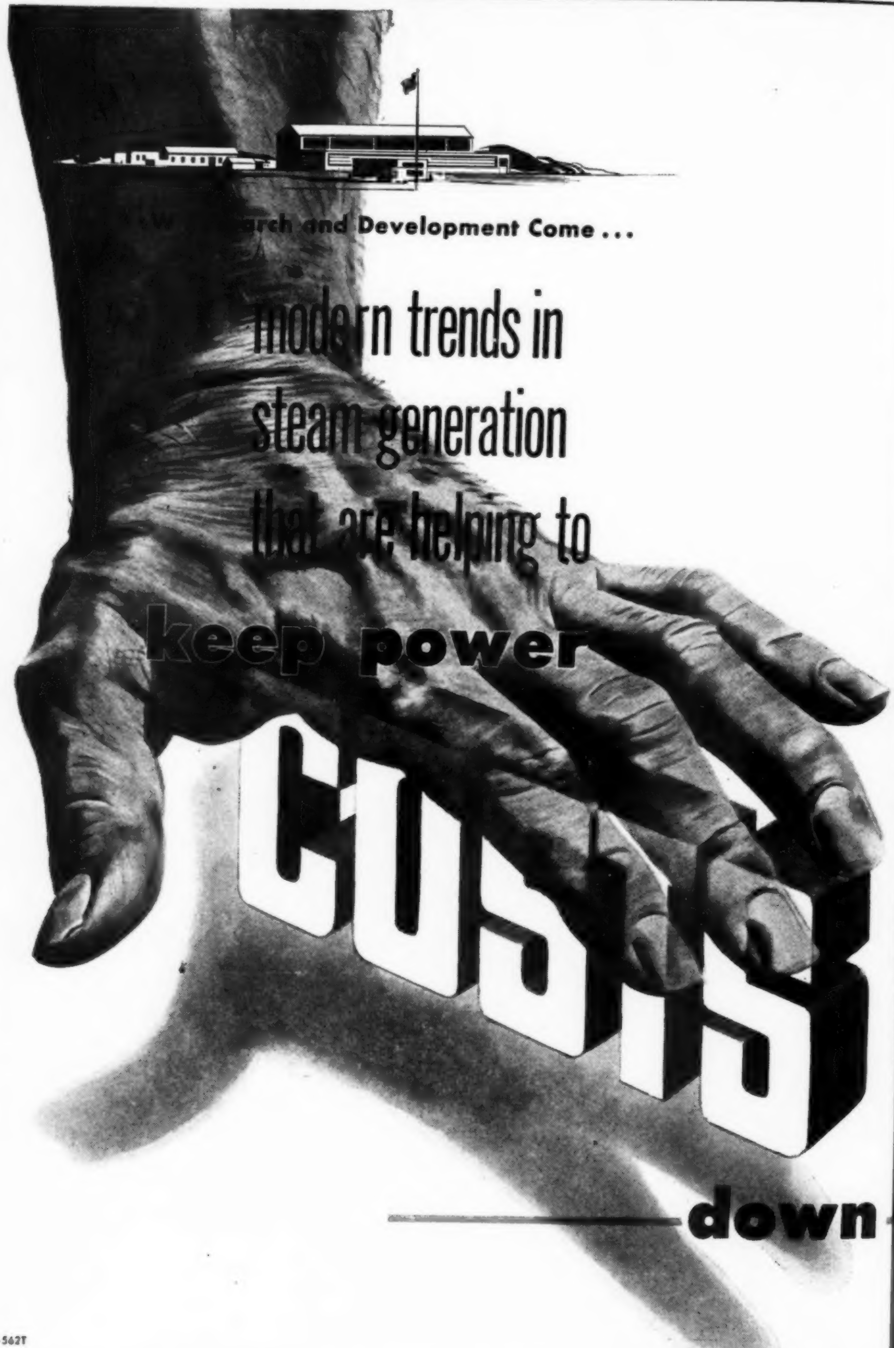
and Development Come ...
modern trends in
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that are helping to
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COSTS
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G-562T

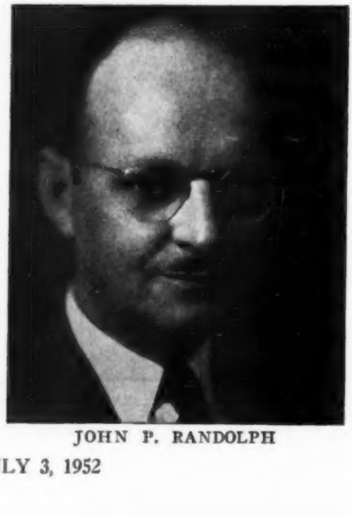
# Pages with the Editors

WHEN the United States Supreme Court decided the Hope Natural Gas Case in 1944, it placed its seal of approval on a judicial "hands-off" policy towards state and Federal regulation of public utilities. This negative attitude had been growing for more than a decade following the Los Angeles Case in 1933. But, prior to that, the Supreme Court had supported a doctrine of fairly close judicial supervision over regulation—a doctrine laid down in 1898 in Smyth *v.* Ames.

WHEN we look at other fields of the law we see a similar build-up of Federal court interference with state action in such cases as race-segregated education and housing, religious teaching, state censorship of motion pictures, and the procedural rights of persons accused of crime. In short, the highest court seems to be going through a phase of preoccupation with personal liberties, just as it did a half-century ago in connection with the regulation of property rights by the states.

ONE wonders whether this judicial mood will be any more lasting in the cases involving personal liberties than it was in the cases involving property rights under the Fourteenth Amendment. After all, there are some things which must be left to the states and to the tastes and customs of local majorities, including the policing of human behavior. The present temper of the highest court seems to stress *Federal* as distinguished from *state* surveillance of personal liberty and the rights of minorities in such matters as entertainment, education, and racial discrimination.


LYON F. TERRY


JOHN P. RANDOLPH

BY comparison, only two decades ago the highest court was telling the state commissions just how they had to regulate public utility rates, with respect to such details as measures of value and the rate of return, under the constitutional guaranties of the Fourteenth Amendment. It is interesting to note that in one recent case, which by sheer coincidence happened to combine elements of both the court's "hands-off" regulatory policy and the more recent personal liberty policy, the court majority swung the balance in favor of giving the regulatory commission liberty of action in the first instance.

This was the celebrated Capital Transit Case, which held that there is

no constitutional guaranty for a streetcar passenger's right to enjoy his ride without the distraction of radio music or commercial advertising broadcasts in the public vehicles. The court majority pointed out that if public dissatisfaction with the way a regulatory commission decides such matters reaches the point of a demand for legislative correction, it is up to the people's elected representatives to make the change—not the courts.

ONE might speculate somewhat cynically whether the wax and wane of Supreme Court emphasis on regulatory supervision may presage a similar diminution of its aggressive protection of minority rights which now prevails. After all, if other professions and arts, such as medicine, can have their fads and shifts of theory (remember the tooth-pulling medical rage of the twenties?), why should not the judges be entitled to cycles of judicial emphasis, so to speak? But the trouble with centralized Federal supervision, even in the field of personal liberties, is that it can have the self-defeating effect of tying the hands of state regulation and state legislation.

THE leading article in this issue examines the legalistic regulatory approach to rate making during an inflation. It comes from the authoritative authorship of the general solicitor of the National Association of Railroad and Utilities Commissioners. He is JOHN P. RANDOLPH, former member of the Missouri Public Service Commission, as well as a native of Missouri and a graduate of its state university ('21), following military service with the AEF during World War I. JUDGE RANDOLPH was actively engaged in the general practice of law in the state and Federal courts for twenty-five years in St. Joseph, Missouri, before his appointment as general counsel to the Missouri Public Service Commission in 1940. He became a member in 1949 and came to Washington to his present post in 1951.

ANOTHER regulatory article (beginning on page 19) is by RALPH E. BADGER, PhD. In 1929 DR. BADGER became executive vice president of the Union Guardian Trust Company in Detroit, Michigan. In 1933 he became pres-

RALPH E. BADGER

ident of Investment Counsel, Inc., a position he still occupies. He has been actively engaged as an expert in rate cases and is the author of several books, including the recent *Investment Principles and Practices* (fourth edition, 1951), in which he collaborated with Professor Harry G. Guthmann of Northwestern University. DR. BADGER got his PhD degree from Yale University ('21), and was formerly professor of economics at Brown University.

* * * *

LYON F. TERRY, whose article on natural gas resources under Federal regulation begins on page 11, is a vice president of The Chase National Bank. He joined the bank staff as a petroleum and natural gas engineer in 1936. He is an engineer graduate of the University of Michigan ('15) and has spent many years in petroleum and natural gas engineering. He is a member of the American Institute of Mining Engineers, the American Association of Petroleum Geologists, the American Petroleum Institute, as well as other oil and gas trade associations.

THE next number of this magazine will be out July 17th.

The Editors

# Coming IN THE NEXT ISSUE

★

### INTERIOR'S ADVENTURES IN THE MISSOURI BASIN. PART I.

Although the Missouri river has been the subject of various forms of government planning and improvement for nearly a century, last spring it produced one of the greatest floods in its history. But apparently government planning for Missouri basin improvement is only beginning to be translated into the active promotional stage. Recently the Interior Department brought out a thick volume, which it called a "reconnaissance survey"—likely to lead to other more detailed surveys. The nationally known syndicated columnist, Ray Tucker, gives us a swift-moving description of Interior's plan and where it is likely to lead.

### WHAT'S BEHIND THE PUBLIC POWER PREFERENCE CLAUSE?

What would happen if Congress were to pass a law penalizing cigarette smokers in four-fifths of the states by granting special subsidies to smokers in the other states? The question almost answers itself. Angry voters would drive the Congressmen out of office. George W. Keith, Cincinnati professional writer, has written a clear-cut and thought-provoking account of how the preference clause works and who benefits and who pays as a result.

### GAS REGULATION FROM THE CONSUMERS' VIEWPOINT

Natural gas, which was once a nuisance to the oil prospector, today forms the background for not only one of the fastest-growing industries in the United States, but also presents some of the most difficult problems which this country will soon be called upon to solve in one way or another. Chairman John C. Doerfer of the Wisconsin Public Service Commission gives us a gas-consuming state commissioner's viewpoint on modern regulatory problems in the natural gas field.

### IS CALIFORNIA REGULATION OUT OF STEP?

Harassed California utility management feels that it is a bit behind other states, and points to a difficult market for securities to finance the state's burgeoning growth. It is a question with angles—and angles. James H. Collins, California business writer and editor, places his journalistic stethoscope on the operation of regulation in the Golden state.

★

**Also . . .** ***Special financial news, digests, and interpretations of court and commission decisions, general news happenings, reviews, Washington gossip, and other features of interest to public utility regulators, companies, executives, financial experts, employees, investors, and others.***

# Remarkable Remarks

*"There never was in the world two opinions alike."*
—Montaigne

---

**D. A. Hulcy**
*President, Lone Star Gas Company.*

"We are just two jumps away from the auction block of Socialism. I cannot overemphasize the gravity of this hour. The outer trappings of an artificial prosperity cannot obscure the raw bones of disaster."

**Editorial Statement**
*The Wall Street Journal.*

"There is no such thing as responsibility in government for the well-being of its people without power to dictate their coming and going. But the power that comports with such a responsibility can destroy that well-being."

**Harry F. Byrd**
*U. S. Senator from Virginia.*

"Our governmental course in late years has been proceeding steadily towards state Socialism. These new policies of government, unless quickly checked, will destroy the American system. America today stands at the crossroads."

**Editorial Statement**
*Spokesman Review.*

"Unless we get over this mania for passing laws to compel people to work less, the end of free enterprise is not far off. When private initiative is hamstrung by too many laws it quickly languishes and dies. Then we enter the socialist state."

**Benjamin F. Fairless**
*Chairman of the board, United States Steel Corporation.*

"To put our faith in price controls while we continue to inflate our money supply is a good deal like plugging up the safety valve on a steam boiler, and then piling on more fuel. Something, somewhere, is just naturally bound to go bust some time."

**Val Peterson**
*Governor of Nebraska.*

"I don't believe in asking for Federal money until we show the color of our own money. If the states and the localities are constantly going to run to Washington for help, we won't have any states in a few years. As a matter of fact, we're pretty well along that way right now."

**John T. Wood**
*U. S. Representative from Idaho.*

"No one man is going to save the Republic. Yet, there are many voters today who are groping in darkness, unable themselves to make the bold decision which will halt this trend toward empire, in the vain hope that some popular hero will come along to do the job for them. Therein lies America's greatest danger."

WALT HORAN
*U. S. Representative from Washington.*

". . . scarcely a single activity exists for which Federal expenditures are made but has some measure of duplication to other activities in the states—or private enterprise."

CHARLES F. MCCAHILL
*President, American Newspaper Publishers Association.*

"Many bureaucrats in government appear to prefer to function without knowledge of the people, and resent the manner in which newspapers are living up to their responsibility to inform the public."

EDWIN G. NOURSE
*Former chairman, President's Council of Economic Advisers.*

"The freedom to save and invest, by whatever means we wish, is a privilege we enjoy under our free enterprise system. In exercising that privilege, we actually help to *safeguard* this proved system of ours. For the money we place in life insurance and other voluntary plans for family security is in turn invested to create more and better goods and services—and, through them, brings a richer life to all."

TOWNER PHELAN
*Vice president, St. Louis Union Trust Company.*

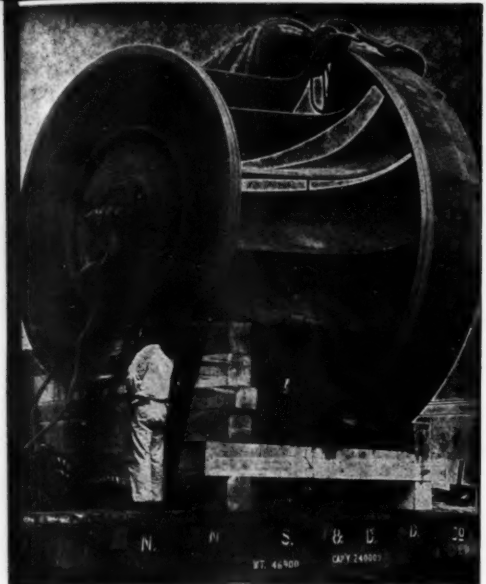
"The great moral issue of our age is the issue of liberty *versus* authority. Is man a moral being, with the unalienable right to direct his own life on a basis of voluntary choice, or is he a slave who must obey authoritarian dictates? One of the important battlegrounds of freedom is that in which the issue of free labor or slave labor must be determined. If man is a slave, the corruption which characterizes this age will continue and will grow. If we regain our liberties, a rebirth of decency and morality inevitably will follow."

KEITH FUNSTON
*President, New York Stock Exchange.*

"The investor may become a force of vast importance. When millions of people have the same idea on the same subject, something will give way. The stockholder may be the deciding factor in the relations between management and labor. The stockholder may be the deciding factor in government tax policy, such as double taxation of dividends or the 6-month holding period currently prescribed in the capital gains tax law. And, the stockholder may become the deciding factor in industry's relations with the consumer."

HENRY HAZLITT
*Columnist.*

"The inflation, in brief, has been government-created. And the alleged remedy of price-and-wage control (even if there had been no union-leader insurrection) is completely spurious. If the volume of money and bank credit were prevented from expanding, price control would be unnecessary. But as long as money and bank credit are being substantially increased in relation to the volume of goods, price control will continue to be worse than futile; for it distorts and disrupts production at the same time as it destroys economic freedom."



RUNNER FOR BUGGS ISLAND DEVELOPMENT

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## NEWPORT NEWS

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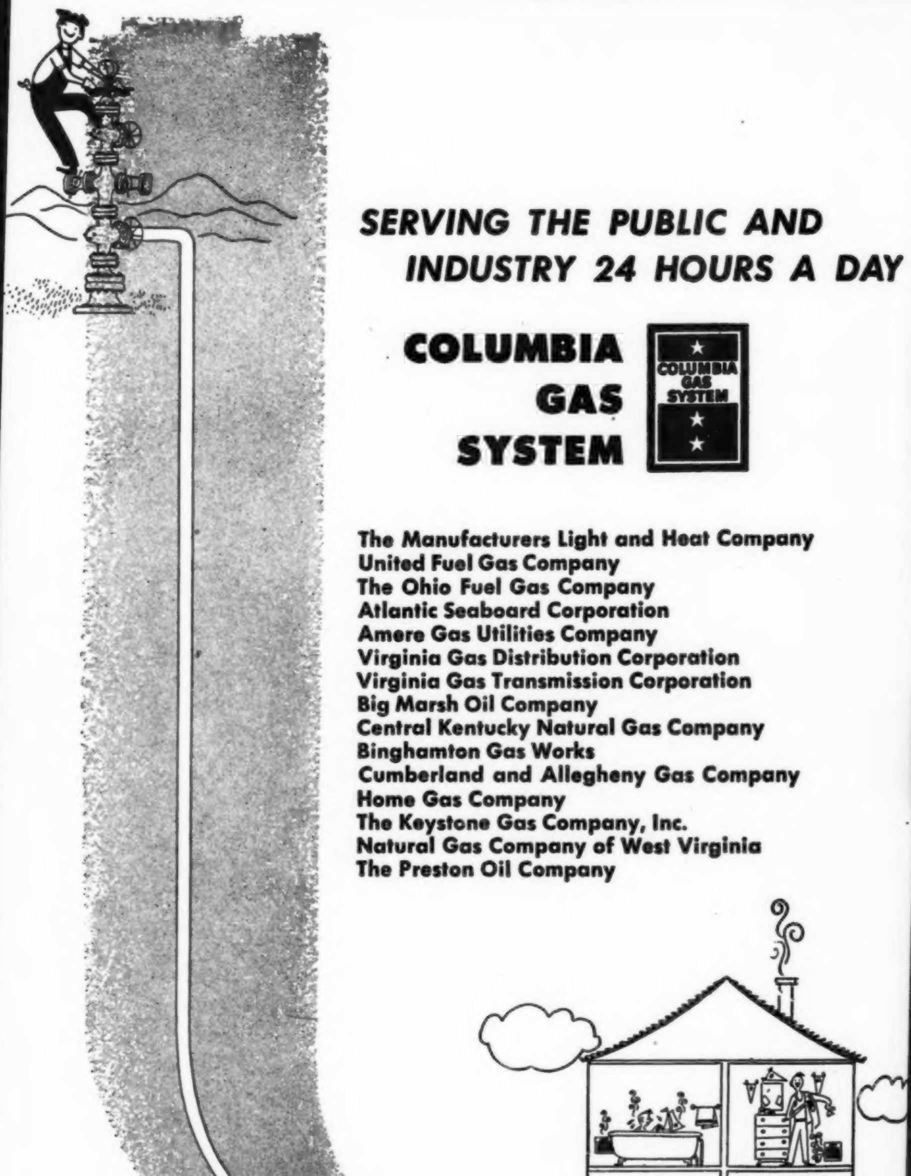
Newport News, Virginia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Virginia Gas Transmission Corporation
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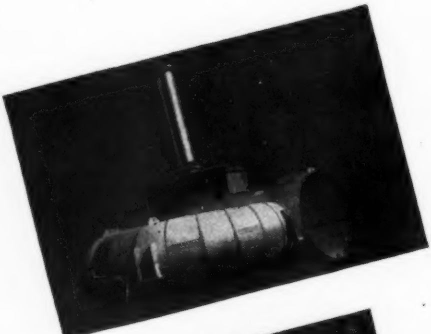

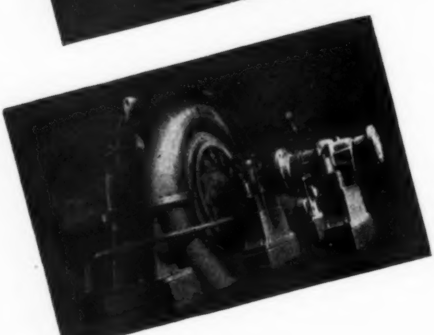

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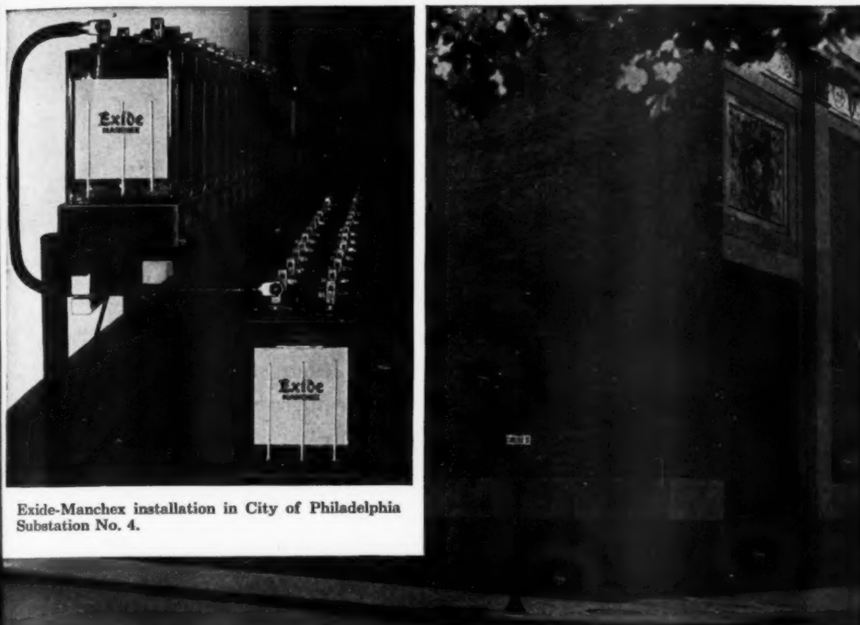

Exide-Manchex installation in City of Philadelphia Substation No. 4.

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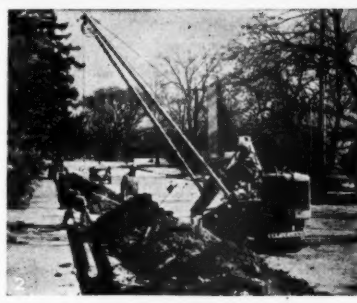

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# Utilities Almanack

## July

| | | |
|---|---|---|
| 3 | Th | ¶ *American Institute of Electrical Engineers will hold Pacific general meeting, Phoenix, Ariz., Aug. 19-22, 1952.* |
| 4 | F | ¶ *Pacific Coast Gas Association will hold annual meeting, Los Angeles, Cal., Sept. 3-5, 1952.* |
| 5 | Sa | ¶ *American Society of Civil Engineers will hold centennial celebration, Chicago, Ill., Sept. 3-13, 1952.* |
| 6 | S | ¶ *Maryland Utilities Association will hold meeting, Virginia Beach, Va., Sept. 5, 6, 1952.* |
| 7 | M | ¶ *National Housewares & Home Appliance Manufacturers Exhibits begin, Atlantic City, N. J., 1952.* |
| 8 | Tu | ¶ *Wisconsin Utilities Association will hold management conference, Land O'Lakes, Wis., Sept. 7-9, 1952.* |
| 9 | W | ¶ *Rocky Mountain Electrical League will hold fall convention, Glenwood Springs, Colo., Sept. 7-10, 1952.* |
| 10 | Th | ¶ *North Dakota Association of Rural Electric Co-operatives begins meeting, Dickenson, N. D., 1952.* |
| 11 | F | ¶ *American Standards Association will hold national standardization conference, Chicago, Ill., Sept. 8-10, 1952.* |
| 12 | Sa | ¶ *American Society of Mechanical Engineers will hold fall meeting, Chicago, Ill., Sept. 8-11, 1952.* |
| 13 | S | ¶ *Illuminating Engineering Society will hold national technical conference, Chicago, Ill., Sept. 8-12, 1952.* |
| 14 | M | ¶ *New England Gas Association will hold appliance servicing conference, Boston, Mass., Sept. 11, 1952.* |
| 15 | Tu | ¶ *Mid-West Gas Association will hold gas school and conference; Ames, Iowa, Sept. 11, 12, 1952.* |
| 16 | W | ¶ *Michigan Independent Telephone Association will hold annual convention, Lansing, Mich., Sept. 12, 1952.* |

*Courtesy, Texas Eastern Transmission Corporation*

Over the Hills and Faraway!

*Soft dirt cushioning on a rocky Tennessee hillside pipeline excavation.*

Public Utilities
FORTNIGHTLY

VOL. L, NO. 1 JULY 3, 1952

# Rate Making and Inflation

*Inflation—rapid rising cost of plant equipment, payrolls, taxes, all other operating expenses—means that state commissions will have to take a more practical view of the "original cost" concept in utility rate making. What are the factors involved? What can be done? Can the rate of return be used as an escape valve? What is the "law" involved in this situation?*

BY THE HONORABLE JOHN P. RANDOLPH*
GENERAL SOLICITOR, NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

RATE making has never been an exact science that could be reduced to a formula. If it were only a matter of formula there would be no need for regulatory commissions. Each case requires the exercise of an informed judgment on the part of the regulators. The problems that have arisen during recent years to torment the rate-fixing bodies demonstrate the futility of searching for an exact formula to be applied in all cases as was the tendency of some regulators in the not too distant past.

The history of rate making includes more than half a century of legal conflict. Many crucial battles have been fought and it is fair to say that in recent years rate regulation has been passing through its own postwar period. Unfortunately, what many had looked forward to as a new era of sim-

*For additional personal note, see, also, "Pages with the Editors."

plified regulation has coincided with post-World War II, with the result that past legal problems fade into insignificance when compared to the complex postwar economic problems that must be met and solved in a critical period when our entire economy is threatened by inflation. The past decade has seen progressive dollar devaluation and the threat of further inflation hangs over our heads.

As an aid to the solution of current regulatory problems, it may be helpful to explore briefly what has been involved in the legal conflict, to pin down as firmly as possible just exactly what has been settled, to discuss a few of the new problems that must be met and solved in a critical postwar inflationary period, and to point out some of the methods that have been used to cope with the problem of inflation. The following is designed to provide reference and source material along such lines:

### *History of Legal Conflict*

THE Granger cases, Munn *v.* Illinois (1877) 94 US 113; Chicago, B. & Q. R.R. *v.* Iowa (1877) 94 US 155; and Peik *v.* Chicago & Northwestern Ry. (1877) 94 US 164, established the right of the state to control rates charged by businesses affected by a public interest. In these cases no limit was placed on the state's power to regulate, and the amount of the rate fixed was supposed to depend solely on the discretion of the legislature. These decisions were first limited in Chicago, Milwaukee & St. Paul Ry. *v.* Minnesota (1890) 134 US 418, where the Supreme Court held unconstitutional a statute which had created a commission with power to fix rates, the reasonableness of which had been held to be conclusive on the courts. The ground of the Supreme Court's opinion was that the question of what constituted a reasonable rate was inherently a judicial one, and that to commit this to the commission or legislature so as to foreclose judicial consideration of it violated the due process clause of the Fourteenth Amendment. In this case, no distinction was made between "unreasonable rates" and "confiscatory rates." The concept of confiscation was first applied in Reagan *v.* Farmers Loan & Trust Co. (1894) 154 US 362, the first case to hold rates established by state regulation so low as to be invalid under the Fourteenth Amendment. In this case the Supreme Court enjoined the enforcement of a rate which prevented an efficiently operated railway from paying the interest on its bonds.

SMYTH *v.* Ames (1898) 169 US 466, introduced into the field the standard of "fair value." A Federal circuit court enjoined the enforcement of railroad rates set by a state legislature, the revenues from which were barely sufficient to pay operating expenses of certain carriers and less than sufficient in the case of other carriers. The Supreme Court affirmed, holding the rates confiscatory as not permitting a fair return upon the fair value of the property devoted to public service. This was the rule urged upon the court by representatives of the public and the test of confiscation actually was laid down in broad enough terms so that standing alone the decision would not have interfered with regulatory flexibility. The difficulties came and the seeds of

the long legal conflict were really sown later when the fair value rule for testing *confiscation* was translated into what was, in effect, a reproduction cost new test of confiscation.

The translation of the fair value rule into what was, in effect, a reproduction cost rule came about through a series of judicial decisions, the culmination of which was McCardle *v.* Indianapolis Water Co. (1926) 272 US 400.[1]

THIS rigid test of confiscation was in turn translated into a substantive guide for rate making. As pointed out in Mr. Justice Brandeis' dissenting opinion in Southwestern Bell Teleph. Co. *v.* Public Service Commission of Missouri (1923) 262 US 276, at 296:[2]

> . . . But the commissions undertook to make the rule their standard for constructive action. They used it as a guide for making, or approving, rates. And the tendency developed to fix as reasonable, the rate which is not so low as to be confiscatory.
>
> Thus the rule which assumes that rates of utilities will ordinarily be higher than the minimum required by the Constitution has, by the practice of the commissions, eliminated the margin between a reasonable rate and a merely compensatory rate . . .

The end of the legal conflict was foreshadowed with the decision in Federal Power Commission *v.* Natural Gas Pipeline Co. (1942) 315 US 575,[3] and finally came, of course, with the decision in Federal Power Commission *v.* Hope Nat. Gas Co. (1944) 320 US 591.[4]

[1] PUR1927A 15.
[2] PUR1923C 193.
[3] 42 PUR NS 129.
[4] 51 PUR NS 193.

### *What Has Been Settled*

AS is shown by the history of the legal conflict, the basic issue came to be whether rate-making agencies were *required* by the Federal Constitution to give predominant weight to reproduction cost in arriving at a rate base, irrespective of the economic consequences or other considerations. All the Supreme Court has said is that the Constitution does not require any formula (specifically reproduction cost) for a rate base. In this current inflationary period it is important to remember that the Court has not said that it is unfair or improper to consider a major change in price levels. This open door is especially important if the change appears to be permanent or of long duration.

From the standpoint of regulatory flexibility, it is important that the new judicial standards of constitutional law should not be translated into new and different rigid rate-making formulae. The distinction between the functions of courts and the functions of commissions, as pointed out by Mr. Justice Brandeis in the Southwestern

> ¶ "RATE *making has never been an exact science that could be reduced to a formula. If it were only a matter of formula there would be no need for regulatory commissions. Each case requires the exercise of an informed judgment on the part of the regulators."*

Bell Case, is fundamental and should not be overlooked. The responsibility to fix reasonable rates now rests squarely with the commissions, and this responsibility cannot be discharged through the employment of any formula which seeks merely to arrive at a rate which is not so low as to be confiscatory. See B. W. Lewis, "Reasonable and Barely Nonconfiscatory Rates," 15 *Cornell Law Quarterly* 573 (June, 1930); State of New York *v.* United States (1947) 331 US 284[5]; New England Teleph. & Teleg. Co. *v.* Dept. of Public Utilities (1951) 97 NE2d 509.[6]

NOTICE should also be taken of a few requirements that the Hope Case did not relax, and which it is particularly important for commissions to observe in order to avoid courts taking over their rate-making functions. Thus it is still necessary that the rate-making agency spell out the basis for its decision. See Mississippi River Fuel Corp. *v.* Federal Power Commission (1947) 163 F2d 433[7]; *Re* New England Teleph. & Teleg. Co. (1949) 66 A2d 135 (Vermont)[8]; City of Newport *v.* Citizens Utilities Co. (1950) 70 A2d 590 (Vermont)[9]; Commonwealth Teleph. Co. *v.* Public Service Commission, 32 NW2d 247 (Wisconsin).[10] These decisions represent an application of the rule, much emphasized in recent years by the United States Supreme Court, that adequate findings of fact by the administrative tribunal are essential to permit proper judicial review. See Florida *v.* United States (1931) 282 US 194; Phelps Dodge Corp. *v.* NLRB (1941) 313 US 177; United States *v.* Carolina Freight Carriers Corp. (1942) 315 US 475[11]; Yonkers *v.* United States (1944) 320 US 685[12]; Colorado-Wyoming Gas Co. *v.* Federal Power Commission (1945) 324 US 626[13]; North Carolina *v.* United States (1947) 325 US 507. Any regulator or staff member who is faced with the problem of drafting an opinion or finding would be well advised to study carefully Judge Stephens' well-known opinion in the case of Saginaw Broadcasting Co. *v.* Federal Communications Commission, 96 F2d 554, which spells out in some detail the necessary contents of findings.

MUCH of the foregoing is brought out in an address which the late John E. Benton, then general solicitor of the National Association of Railroad and Utilities Commissioners, delivered at the 1945 convention of the NARUC. In this address Mr. Benton noted that "emancipation places upon those who are set free the responsibilities of freedom." Cf. Knoxville *v.* Water Co. 212 US 1, 18:

> The courts, in clear cases, ought not to hesitate to arrest the operation of a confiscatory law, but they ought to refrain from interfering in cases of any other kind. Regulation of public service corporations, which perform their duties under conditions of necessary monopoly, will occur with greater and greater frequency as time goes on. It is a delicate and dangerous function, and ought to be exercised with a keen

5 69 PUR NS 278.
6 88 PUR NS 73.
7 69 PUR NS 129.
8 79 PUR NS 508.
9 82 PUR NS 125.
10 73 PUR NS 97.
11 43 PUR NS 423.
12 52 PUR NS 504.
13 58 PUR NS 94.

## Regulatory Responsibility during Inflation

"REGULATION, *if it is to fulfill its responsibilities to the public of seeing to it that utility services continue to grow and improve, must recognize the problems presented by inflation and cope with them. Some of the effects of inflation on the expenses of doing business are quite obvious. Thus higher wage and material costs are immediately reflected, and no one can quarrel seriously with permitting the recovery of those costs through repricing the service, just as nonregulated business has done.*"

sense of justice on the part of the regulating body, met by a frank disclosure on the part of the company to be regulated. The courts ought not to bear the whole burden of saving property from confiscation, though they will not be found wanting where the proof is clear. The legislatures and subordinate bodies, to whom the legislative power has been delegated, ought to do their part.

Our social system rests largely upon the sanctity of private property, and that state or community which seeks to invade it will soon discover the error in the disaster which follows. The slight gain to the consumer, which he would obtain from a reduction in the rates charged by public service corporations, is as nothing compared with his share in the ruin which would be brought about by denying to private property its just reward, thus unsettling values and destroying confidence. On the other hand, the companies to be regulated will find it to their lasting interest to furnish freely the information upon which a just regulation can be based.

MR. BENTON, in the address referred to above, also touched upon the subject of inflation. His ideas on that subject will be developed more fully below. It is sufficient to observe here that Mr. Benton felt that recent decisions of the United States Supreme Court give assurance that problems such as those brought about by severe inflation can be dealt with effectively by commissions.

### *New Economic Problems*

As has been indicated, inflation is the dominant economic fact of today. All of the price indices show that our economy is experiencing the most severe inflation in its entire history. Even the most conservative index, the CPI, has risen to about 85 per cent above the 1935-39 level. This means that the dollar of today is worth about one-half what it was fifteen years ago. This, then, is the new economic fact

that distinguishes the regulatory problems of today from those of the prewar era. Regulation, if it is to fulfill its responsibilities to the public of seeing to it that utility services continue to grow and improve, must recognize the problems presented by inflation and cope with them.

Some of the effects of inflation on the expenses of doing business are quite obvious. Thus higher wage and material costs are immediately reflected, and no one can quarrel seriously with permitting the recovery of those costs through repricing the service, just as nonregulated business has done. This would present no particular problem for regulators except for the fact that the severity and rapidity of inflation, coupled with the time required for the regulatory process, quite frequently result in the prescribed rates producing a lower earnings level than was deemed fair and reasonable by the regulatory commission. This is particularly likely to occur when service rates are set on the basis of financial results of past periods. Another effect of inflation on the expenses of doing business is not quite so obvious but no less serious because it results in overstating even the number of dollars of profit on the books of the utility. This comes about through charging the expenses with an insufficient number of dollars of depreciation accruals by basing such accruals on historical cost figures which have been rendered obsolete by the inroads of inflation.

On the investment or capital side, the effects of inflation are just as serious and no less important. Some of these effects are immediately apparent. Thus, because of inflation the average book investment required for each unit of revenue-producing plant tends to increase because of growth and normal plant turnover. But there are more basic and fundamental problems which regulators must somehow meet and solve.

FUNDAMENTALLY, these problems stem from the fact that the earnings, or profits, are stated on the books of the utility in units (dollars) that are smaller than the units invested in the business. The prewar, or 1940, investor devoted large-size, full-value dollars to the enterprise. Since then, the dollars have shrunk in value or size by about one-half. Not all utility investors, of course, invested their money at the same time. Consequently, not all the invested dollars had the same value at the time of investment, since the price level has been constantly changing. Inequities obviously result from this situation, and justice would seem to require some adjustment so that the past investors will not be exploited in greater and greater degree, with the danger that investors may lose confidence in such investments, thus increasing capital costs.

Inflation has also posed serious problems in regard to plant replacements. With prices rising in such marked degree, it is obvious that depreciation charges based on original cost will be inadequate to maintain the plant. This situation requires that investors provide ever-increasing amounts of capital merely to continue furnishing service. Earnings on that capital will, of course, be a burden (increased by tax load) on future customers for a cost which should have been borne by present customers.

*Methods Used to Cope with the Problems of Inflation*

INFLATION problems are of recent origin and are still in the process of crystallization. The development of methods to cope with the problems is thus still in the exploratory stage. Recently a number of commissions have found that some of the effects of inflation can be alleviated by placing more emphasis on the future instead of the past. Since rates are established for a reasonable period in the future, it is entirely proper to anticipate what the effects of inflation will be during such period. This procedure has been followed in several states and allowances made for declining earnings through either the rate base, the rate of return, or by specific allowances of income or by using a future test period. Whatever the form of allowance, an attempt was being made to make it possible for the utility to realize the rate of earnings that was deemed reasonable. This was clearly recognized by the public service commission of Missouri in its decision in a case involving the Southwestern Bell Telephone Company (Case No. 12,100), decided on January 15, 1952, in which the commission said:

> In order to prescribe rates which will give applicant a reasonable average return in the future we must again give serious consideration to the factors which have caused the diminution of its rate of return in the past and which we are convinced will cause its rate of return, at least in some degree, to decline in the future.

THE field of developing methods to cope with the more basic and fundamental effects of inflation on utilities is still largely unexplored. Some aspects of this problem were touched upon by Mr. Benton in his address, previously referred to, where he pointed out that conceivably the matter could be dealt with either by increasing the rate of return or by adjusting the rate base. As between these two alternatives, Mr. Benton favored adjusting the rate base, for the reason that the rate of return approach might necessitate varying rates of return among various utility companies performing the same class of service. This would be due to the differing proportions of investment made at the lower prewar price levels. Mr. Benton notes that this condition might well be misunderstood by the public and be unpopular. Adjustments in the rate base conceivably might be made either on a property approach or on a capital approach.

The property approach would involve arriving at a fair value of the property but, as has been pointed out, this value would not necessarily have to be based upon reconstruction cost new. All that would have to be done

> "THE *problem of inflation is basically an economic problem which can best be solved by the wisdom and ingenuity of regulators rather than by the courts. The courts have placed the responsibility squarely in the hands of the regulators, and they have been freed from rigid legal formulae in discharging that responsibility.*"

would be to recognize in some way the fact that in a period of fast rising prices the value of the property inevitably is in excess of its depreciated original dollar cost.

IF a capital approach is used to arrive at a just rate base, some method would have to be found for expressing original investment in the same units as those used for expressing the income. A simple approach would be to restate the dollars of capital of the company in terms of dollars of today's value. This would require merely the computation of the value of each past year's commitment of capital in relation to the current value through the use of index numbers. In this way, the real rate of return is approximated in a manner similar to that used by the United States Bureau of Labor Statistics, for example, in determining the real wages of employees. A reasonable rate of "real return" might well require more nominal dollars of earnings than are currently being realized. As Mr. Benton has stated:

> For example, if severe inflation shall occur, so that dollars shall shrink in purchasing power to a small fraction of the prewar level, no one but an enemy to Capitalism would advocate that companies owning prewar properties should receive no more dollars for return than they were paid when they received their return in dollars of prewar value.

THE problem of inflation is basically an economic problem which can best be solved by the wisdom and ingenuity of regulators rather than by the courts. The courts have placed the responsibility squarely in the hands of the regulators, and they have been freed from rigid legal formulae in discharging that responsibility. If the new problems are met forthrightly and if adequate findings are made spelling out a sound basis for judgments and conclusions, there is no reason to believe that there will be any necessity for the courts again taking over the function of rate making. A tendency in this direction on the part of some courts is now being evinced. This tendency can best be forestalled by the regulators themselves—recognize the problem and deal with it promptly, intelligently, and courageously.

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## Practical Effects of Socialism in England

*"THE walls of the prison close in day by day; the area of enterprise shrinks. Day by day the ceiling of opportunity is lowered. We prisoners are charged more for the expense of multiplying jailers. Food and drink diminish in quantity and quality month by month. There is no incentive to bold undertakings except a heartless propaganda which urges all dogs collectively to jump the moon while keeping chained each dog with a spring or heart in him.*

*"Socialism, as now interpreted here in England, is competition without prizes, war without victory, and statistics without end."*

—EXCERPT *from London Times.*

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# Natural Gas Supply and Federal Regulation

*Natural gas from Texas reached the New York city area more than a year ago and has now become available in part of New England. Last year the United States produced 8 trillion cubic feet of natural gas—an increase of 15.6 per cent over 1950 production and 61 per cent more than produced in 1946. In this phase of active expansion, two questions arise: (1) Will the supply of gas be adequate to meet the increasing demands? (2) Does the welfare of the consumer require Federal regulation of the gas producer? This article suggests that Federal regulation would result in reducing the supply available to residential consumers.*


By LYON F. TERRY*
VICE PRESIDENT, THE CHASE NATIONAL BANK


THE proved reserves of natural gas in the United States are estimated annually by the committee on natural gas reserves of the American Gas Association. Its recent estimate as of December 31, 1951, was 194 trillion cubic feet. This is 24.3 times last year's production and, with the rapid expansion of the gas business since World War II, that ratio has been decreasing. Five years previously the ratio was 32.5. Production will continue to increase rapidly and by 1960 may readily reach 15 trillion cubic feet. And the ratio of reserves to annual production, now 24.3, will probably continue to decrease, but that need not cause concern so long as additions to known reserves substantially exceed production.

In 1951, for example, additions to reserves by discoveries, extensions, and revisions were estimated at 16.2 trillion cubic feet, or slightly more than twice as much as production. Similarly, for the past five years about two cubic feet, on the average, have been added to known reserves for each cubic foot of gas produced. It is this continual increase in proved reserves that is necessary to keep the industry on a sound basis.

WHILE the total future supply, including the reserves yet to be discovered, cannot even be approximated, reasons have previously been presented by me for estimating, on most con-

*For additional personal note, see, also, "Pages with the Editors."

servative premises, that the future recoverable gas supply will be some amount *in excess* of 500 trillion cubic feet.[1] Of that total, 180 trillion were then proved reserves, and the balance, something in excess of 320 trillion, was estimated as the gas to be found in the future.

Since making that estimate, I have had no reason to think it is too high. In fact, review of the National Petroleum Council's report on "Future Supplies of Oil and Gas," conversations with other engineers, and consideration of the recent rapid rate of additions to proved reserves lead me to believe that the 500 trillion minimum figure was probably too conservative. In any case, the most important part of the future supply consists of reserves yet to be discovered.

### *Exploration for Future Supplies*

Much of the known reserves of natural gas has been found in the search for crude oil. Natural gas and oil were originated by similar earth processes and are found in nature in the same type of structural formations; hence the future discovery of new gas reserves will require exploration for both oil and gas.

Oil and gas have been produced in this country since 1859. In the early days, production was from shallow depths and from reservoirs that were the most readily found. Early geological surveys by many competing companies revealed the most likely prospective structures. Such exploratory work was followed by geophysical and improved techniques and drilling to greater depths on less perfect and less likely structures and in more remote areas.

Prior to 1900, wells had been drilled to only 3,000 feet. By 1925 tests had gone to 8,000 feet, while recent drillings have exceeded 20,000 feet. The cost of a well, per foot of depth, increases sharply at great depths. Each new field discovered means one less field to be found. No matter how large or small the future discoveries eventually prove to be, they will require deeper and deeper drilling at increasing costs. And to find and gather the future gas supply will ultimately require drilling all prospective areas in locations far from present gas lines, the extension of present mains by an enormous network of pipelines, and exhausting the reservoirs down to the last pound of pressure. This will be accomplished at increasing costs which will need to be paid by the consumers—to the extent that they want the gas.

### *Risks of Exploration*

The oil- and gas-producing industry has built up its present large productive capacity and reserves by developing very effective instruments and procedures. The selection of likely locations to be drilled is based upon geological, geophysical, and other scientific surveys and indications of the subsurface strata. These tools and methods of the explorer are continually being improved. But while such technical processes may reveal the configuration of the underground sediments, they cannot foretell whether the strata studied contain oil or gas. Although science may reduce the chances of a dry hole, only the drill can determine the presence of oil or

[1] "The Future Supply of Natural Gas," by Lyon F. Terry. *1950 Proceedings, American Gas Association,* pages 155-159.

gas. And in practice the risk incurred in the drilling of what are termed "rank wildcats"—*i.e.,* tests for the purpose of finding new oil or gas fields—is exceedingly great. On the average, only one rank wildcat out of nine is successful.

The mathematics of wildcatting is summarized impartially and professionally in the annual reports of the committee on exploratory drilling of the American Association of Petroleum Geologists, headed by Dr. Frederic H. Lahee, geologist and research counselor of Sun Oil Company. His latest report[2] reveals the following significant ratios:

Of all new-field or rank wildcat tests completed in 1944-46:

> 1 in 9 was successful; *i.e.,* was not a dry hole.
>
> 1 in 44 discovered a field of at least 1,000,000 barrels of reserves.
>
> 1 in 967 discovered a field having 50,000,000 barrels of reserves; *i.e.,* what is usually referred to as a major field.

Of the total rank wildcats drilled in the year 1950:

> 24 per cent were drilled and/or financed by major companies.
>
> 76 per cent were completed by minor companies or independents.

Of the total rank wildcats completed in 1950:

> 18 per cent of those completed by major companies were successful.
> 9 per cent of those by minors and independents were successful.

WHILE one rank wildcat in nine tests is rated as a discovery, Dr. Lahee points out that a discovery of a 1,000,000-barrel field is "near the economic limit" and the odds of such success are only one in forty-four. Wildcatting is a risky business. His data also show that, while the major companies are almost twice as successful per test as the independents, the independents drill three-fourths of the rank wildcats. The independents apparently employ technical methods to a lesser degree than the majors, or take more chances, but, in any case, drill more wildcats.

*This shows the importance of the independent producer in finding new supplies of oil and natural gas.* The record is replete with instances of small independent operators taking chances that the major companies refuse to undertake and finding fields which otherwise would not have been discovered. The Spindletop field, the discovery field in south Texas, was

[2] "Exploratory Drilling in 1950," by Frederic H. Lahee, Bulletin, American Association of Petroleum Geologists, Vol. 35, No. 6 (June, 1951), pages 1123-1141.

¶ "THE *proved reserves of natural gas in the United States are estimated annually by the committee on natural gas reserves of the American Gas Association. Its recent estimate as of December 31, 1951, was 194 trillion cubic feet. This is 24.3 times last year's production and, with the rapid expansion of the gas business since World War II, that ratio has been decreasing. Five years previously the ratio was 32.5.*"

brought in by Captain Lucas after Standard Oil experts had rejected the prospect. The largest oil field in this country, the East Texas field, was found in 1930 by Dad Joiner, financed on a shoestring, after the major companies had scanned the area for years. It takes the independent producers and the random wildcatting to find the new reserves and thus maintain our supply of oil and gas.

### *Federal Regulation of Natural Gas Companies*

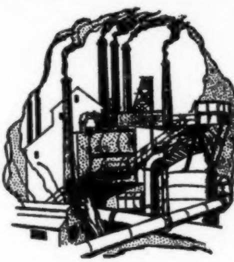
THE Natural Gas Act of 1938 authorized the Federal Power Commission to regulate interstate gas transmission companies. But the act specifically provided that it "shall not apply to . . . the production or gathering of natural gas." However, the commission early claimed jurisdiction over the producing and gathering operations of interstate transmission companies, defined by the act as "natural gas companies" and this has been sustained by the courts. On the other hand, the several state conservation commissions have long since held regulatory jurisdiction over the production of oil and gas, soundly based upon the conservation of natural resources.

To remove any doubt as to the possible jurisdiction of the FPC over natural gas producers other than interstate transmission companies, the Rizley-Moore bills were brought before Congress in 1947, followed by the Kerr Bill, introduced in 1949. The Kerr Bill was passed by Congress in 1950 but was vetoed by the President. Thereafter the FPC proceeded against the Phillips Petroleum Company to ascertain whether it held jurisdiction over that company's natural gas-producing and gathering properties. In July, 1951, the commission announced, in a 4-to-1 decision, that it did not have such jurisdiction. The commission's own finding of its lack of jurisdiction has been appealed to the U. S. Court of Appeals for the District of Columbia by the cities of Detroit, Milwaukee, and Kansas City, and by certain other governmental organizations, in the alleged interest of consumers.

THERE are two general forms of regulation that have become established in the natural gas industry:

(1) Regulation of transmission and distributing companies serving communities of residential consumers. Such companies, like other public utilities, are held to be affected by a public interest and are protected by franchise from competition in their respective territories. To protect the numerous small and otherwise helpless customers of such utilities against possible unreasonable charges for service, their earnings are subjected to regulation. By being protected from competition, the business risks are much reduced and these utilities enjoy an assurance of steady earnings and permanence corresponding to the growth of population in the community served. They are all but guaranteed a profit. Consequently, such companies maintain their credit and finance their growth on the basis of a moderate rate of return.

(2) Regulation of oil and gas producers. Such regulation by state commissions is to insure the conservation of natural resources and to protect one producer against drainage by a neighbor—not to regulate earnings or



## Gas Supply Must Be Rewarded

"THERE *can be a supply of natural gas in this country sufficient to meet the needs of the rapidly increasing demand, provided the gas producers are encouraged to search for new reserves. Exploration is an expensive and hazardous undertaking that must be paid for out of production. The producer is entitled to profits that will induce him to continue exploring. Without such inducement, there would be no further exploration and the available supply of gas would soon diminish."*

prices. The producers have no monopoly, no franchise, and no guaranty of earnings. The law of supply and demand takes care of prices in the gas-producing field where there is plenty of competition among producers and among purchasers.

THE gas producer, to stay in business, must keep on finding new gas reserves. His profits from production must also repay him for his risks and costs of searching for new supplies. The public is familiar with the statements of the large, successful oil companies which show fine earnings, especially in good times. But few are aware of the losses of the hundreds of independent operators who fail and the large amounts spent by wildcatters and promoters attempting to get rich out of oil. Their explorations are a part of the combined effort necessary to find the future supply of gas for this country. It is a hazardous business and the explorers for new supplies can only be induced to carry on if the prospects of high rewards to the successful will make up for the losses of frequent failures.

The American Petroleum Institute estimates the average cost of a wildcat well at $90,000. Would you invest $90,000 of your money in a wildcat venture offering one chance in nine of getting your money back, but only one in forty-four of striking a really profitable field, if you knew you would be regulated down to a 6 per cent return on cost if you struck the pay?

THE economics for producers is entirely different from that of utilities. Six per cent on original cost of

property would be ridiculous for small producers searching for oil and, by Dr. Lahee's careful figures, three-fourths of the rank wildcats are drilled by small producers. And 6 per cent is also untenable to large producers.

Since the FPC has assumed regulation of the production of transmission pipelines, these companies have divorced their producing properties so far as possible, buy their gas supplies from others, and do not drill wildcats in the search for new supplies. Some of the large oil companies have refused to sell gas in any substantial quantities to interstate transmission companies, since they cannot risk being subjected to Federal regulation. If gas production should be regulated, oil production might be next. This holding back of supplies in itself has already made gas less available and more expensive to consumers. And the threat of regulation retards exploration for additional supplies.

THERE is an important and rapidly growing use of natural gas near the gas fields of the Gulf coast by chemical companies which need gas as raw material for making plastics and innumerable other products. Such important companies as Dow Chemical, Mathieson Chemical, Celanese, du Pont, Nueces Rubber, and Monsanto Chemical have built large plants on the Gulf coast, while American Cyanamid, Commercial Solvents, Diamond Alkali, Phillips Chemical, Aluminum Company of America, Texas Eastman, Koppers, Kaiser Aluminum, and others have plants under construction.

Strong political pressure is being exerted to keep Texas and Louisiana gas within those states to help boost industrial growth. Why sell the natural gas, with which these states are blessed, to Northerners who have plenty of coal? Especially why permit its export at ridiculously low prices? Gas consumed within the state where it is produced is not in interstate commerce and cannot be subjected to Federal jurisdiction. Hence, if gas producers selling to interstate pipelines should be subjected to FPC regulation, they would turn to selling locally. And the large oil companies, which are going in for more and more petrochemical production, could utilize their gas supplies by building their own chemical plants to realize the intrinsic value of their gas reserves.

### *The Proponents of Federal Regulation*

NOW there are many good people who would like to see Federal regulation of gas producers. The consumers in the northern states, far removed from the producing areas, naturally would be pleased to see lower prices for natural gas. It would appear to be a simple thing for the FPC to say to the gas producers: "You can only earn 6 per cent on the original cost of your property, less depreciation to date—which would give you, say, four cents per thousand cubic feet instead of the eight cents the purchasing company is paying you." The producer has been getting the eight cents because if one purchaser won't pay such price another will, and, in any case, it is cheaper than coal or oil to the consumer, or he wouldn't buy it. At first glance, cutting back the producer from eight cents to four cents would appear

to be a windfall for the consumer. But would it?

Reducing the price of gas at the well by, say, four cents per thousand cubic feet would affect the residential consumer in the North but slightly. Assuming the reduction to be passed along by the transmission and distribution companies to the residential consumer, it would reduce the price of natural gas for home consumption in Milwaukee, for example, from approximately $1.30 to $1.26 per thousand cubic feet; *i.e.,* by 3 per cent—not enough to matter, if he prefers natural gas fuel. But the reduction from eight cents to four cents would be a serious matter to the producer.

If Federal regulation should follow the practice of transmission line regulation, it would result in setting field prices at levels sufficient to earn an allowable rate of return on cost—6 per cent is allowed transmission companies. This would produce different prices in the same field, depending upon varying costs of the several producers, and would upset the existing regulation of the state conservation commissions. It would no doubt require the obtaining of approval on locations to drill, countless forms, reports, investigations, hearings, and directives. It would force small producers to quit the business and large producers to sell to chemical or other industries locally. It would restrain further exploration and reduce the finding of additional supplies, and thus slow down the rate of discovery. And by the time increasing gas demand caught up with a decreasing discovery rate, the consumers would quit thinking about regulation and would start shouting for more gas at any price.

What is the *real* purpose of the proponents of Federal regulation? Could it be that the consumers want to get their gas to the kitchen stove at less than it is really worth? Certainly the producers should be entitled to fair payment for taking the risk of finding new gas supplies for the ultimate benefit of the consumers, who are in no position to produce gas or search for new gas. The Federal Power Commission does not risk money nor can it find new gas supplies. It is obvious that a 6 per cent return on cost would not be fair pay to the producer and explorer. In the free economics of this country, the gas producers and explorers for gas supplies perform a necessary service for the consumers. The service should be paid for—whatever it is worth. But whether the producer is entitled to adequate compensation or not, he sim-

> "If *Federal regulation should follow the practice of transmission line regulation, it would result in setting field prices at levels sufficient to earn an allowable rate of return on cost—6 per cent is allowed transmission companies. This would produce different prices in the same field, depending upon varying costs of the several producers, and would upset the existing regulation of the state conservation commissions.*"

ply will not go ahead finding new gas unless he profits by so doing. If the consumers could muster enough votes, they could conceivably have their producers regulated. But that would not find the gas for them—it would only slow down the rate of new discoveries.

THE National Petroleum Council's committee on oil and gas availability has prepared a comprehensive report dated January 29, 1952, on *Present and Future Supplies of Oil and Gas.*

Certain significant conclusions of that committee may be quoted as follows:

> The United States and the world can count upon increasing supplies of oil and gas not only for the next few years but for the foreseeable future, provided that *reasonable economic incentives,* adequate materials, and *a favorable climate for private investment prevail.*
>
> The major threat to future oil supplies would be *any interference with economic incentives* which might act to prevent the normal development which would otherwise occur.

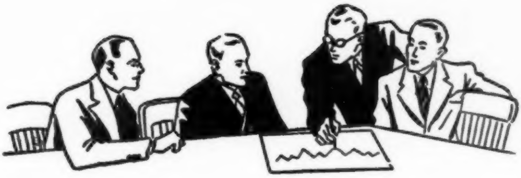
*Conclusion*

THERE can be a supply of natural gas in this country sufficient to meet the needs of the rapidly increasing demand, provided the gas producers are encouraged to search for new reserves. Exploration is an expensive and hazardous undertaking that must be paid for out of production. The producer is entitled to profits that will induce him to continue exploring. Without such inducement, there would be no further exploration and the available supply of gas would soon diminish. Hence, it is to the consumer's own interest to see that the producer be accorded sufficient profit and freedom of action to stimulate him to continue exploring for new reserves of natural gas.

## Power-hungry Bureaucrats

"THE *power-hungry bureaucrats in Washington are so well entrenched that they have become largely self-perpetuating. Administrations come and go, but bureaus go on forever. The President and Congress can create new bureaus and agencies, expand existing ones and add to their powers. But neither the President nor Congress can do much to cut down the permanent bureaucracy. Government agencies and bureaus are relatively independent of the administration and able to exert political pressure on Congress to get what they want. The principal objective of the permanent Washington bureaucracy is the aggrandizement of their own power. They are skilled in lobbying and propaganda and are using the defense emergency to promote further Socialism, to get a strangle hold on the American economy, and to increase and perpetuate their own power. They constitute a totalitarian threat more dangerous than Communism."*

—TOWNER PHELAN,
*Vice president, St. Louis Union Trust Company.*



# Should Fair Return Be Limited to Cost of Money?

**How can utilities continue to attract equity capital on the basis of a "bare bones" return, limited to the cost of capital in the past, when all immediate prospects point to high prices, including the cost of money?**

By RALPH E. BADGER*

THE electric utility industry is annually faced with the task of financing upwards of $2.5 billion of new construction. Of this $2.5 billion (approximately), some $1.5 billion will have to be raised in the capital markets by privately owned utility companies (in competition with other users of capital), about $250,000,000 by public agencies, about $500,000,000 will be provided for through depreciation and amortization charges, and the balance, about $250,000,000, will be financed by common stockholders through what is known as "ploughback."

The $1.5 billion, representing the electric utility industry's annual requirements for new capital, must be acquired by the sale of both stocks and bonds if the capital structure of the industry is to remain in a healthy and sound state. As of the beginning of last year, common stock and surplus constituted 37.43 per cent of total capital employed by privately owned class A and B electric utilities in this country. If this relationship is to continue—that is, if no impairment is to occur in respect to capital structure within the industry—at least $400,000,000 of new capital annually must be obtained by privately owned electric utilities through the sale of common stock.

FOR the years 1946 to 1950, inclusive, the industry as a whole earned about 6.3 per cent on its average invested capital. During this period, private electric utilities raised a total of new capital (including that reinvested by common stockholders) in the amount of $5.86 billion, of which $1.74 billion, or about 30 per cent, was in the form of common stock capital. Thus, during this recent 5-year period, the industry as a whole, with a 6.3 per cent return, was barely able to main-

*For personal note, see "Pages with the Editors."

tain its present distribution of capital structure.

These figures have a considerable significance in the light of recent developments which, because of their impact on the earnings of electric utilities, must have an inevitable tendency to depress the earnings performance of the industry.

Let us consider, for example, the provisions set forth in the 1950 Excess Profits Tax Law, whereby the earnings of electric and gas utilities in excess of 6 per cent on invested capital are subject to excess profits taxes, and whereby telephone companies are limited to a 7 per cent return before being subject to excess profits taxes. This tax limitation in itself, unfortunately, may carry in certain circles an indication of probative support to 6 per cent as the top limit in the matter of return for the electric utility industry. In any event it acts as a limit on the earning capacity of many companies, since it is difficult to visualize a commission allowing rates sufficiently high to subject the companies under its jurisdiction to excess profits taxes, in an effort to permit such companies to earn a return in excess of 6 per cent. More than that, there follows a definite tendency for commissions to find a return as low as 5.5 per cent, or even lower, to be the fair return for electric utility companies. This trend is no doubt helped by the willingness of the Federal Power Commission and other Federal agencies to furnish testimony before state commissions in support of a fair rate of return below 6 per cent.

MANY astute investors already have taken an adverse attitude toward utility common stocks, which, of course, restricts the market for new issues. It will indeed be unfortunate if the industry has to rely upon the uninformed investor for its capital requirements, or for a set of economic conditions that limits the advisability of investment in utility common stocks to periods when they become a good defensive medium for investment.

Now, what steps can be taken by management to prevent the prospective decline in earnings for the industry? The obvious and perhaps the only effective course of action lies in the development of a continuous and aggressive educational campaign designed to clarify the "fair rate of return" concept for the regulatory authorities, both national and state, which authorities in the last analysis will determine the rate at which the industry will earn.

The first step in this educational campaign, it seems to me, is to emphasize the broad distinction which exists between the "cost of money or capital" concept on the one hand and the "fair rate of return" concept on the other. These two concepts are related at only one point. Obviously, any return which is below the cost of money is confiscatory and utterly fails to meet the test of "fair rate of return." But the converse of this proposition—that cost of money can measure the *fair* return—does not follow at all. There is no necessary relationship between the two concepts—except at the point of lowest level.

"COST of money" means either the imbedded cost of fixed-charge capital already acquired and employed by the utility, plus an assumed cost of equity capital; or the so-called "spot

cost" of additional or incremental capital computed first by approximating the costs at which debt, preferred stock, and common stock capital may be acquired under current market conditions, and then combining the costs attached to each class of capital into an over-all or composite cost rate, based on an assumed capital structure. If correctly applied, the spot cost of acquiring additional capital should be predicated on a proper or standard capital structure, and not necessarily on the capital structure of the company under review.

A FACTUAL determination of "bare bones" over-all cost of capital for a typical electric utility company today will produce a cost rate of between 5.75 per cent and 6 per cent. Thus, any determination of fair rate of return under 6 per cent is not a fair rate of return—it is simply the "cost of money or capital." The fair rate of return is not actually represented by a per cent rate of return on some predetermined rate base at all—it is in reality the number of dollars the utility requires (1) to meet operating expenses, (2) to service the company's fixed-charge capital, and (3) to provide a return to the common stockholder "commensurate with returns on investments in other enterprises having similar risks." The Supreme Court used almost this identical language in the Bluefield Case.[1] In the Hope Natural Gas Case, again the Supreme Court states:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.[2]

AFTER determining the number of dollars the utility is entitled to earn in order to meet the tests of a fair rate of return, such dollars can then be related to some form of base; *i.e.*, original cost of plant plus net working capital, less depreciation; total investment; the reproduction value of the property devoted to public use, less observed depreciation; or a fair value rate base. The percentage figures so developed, however, become incidental to the problem, not an integral factor in the problem.

This point of view and general approach are extremely important, in

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[1] Bluefield Water Works & Improv. Co. *v.* West Virginia Pub. Service Commission (1923) 262 US 679, PUR1923D 11.

[2] Federal Power Commission *v.* Hope Nat. Gas Co. (1944) 320 US 591, 603, 51 PUR NS 193.

¶ "MANY *astute investors already have taken an adverse attitude toward utility common stocks, which, of course, restricts the market for new issues. It will indeed be unfortunate if the industry has to rely upon the uninformed investor for its capital requirements, or for a set of economic conditions that limits the advisability of investment in utility common stocks to periods when they become a good defensive medium for investment.*"

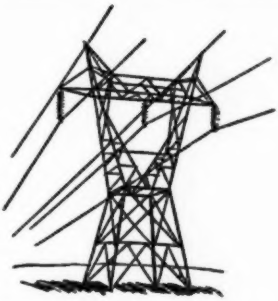
view of the techniques which are frequently used by witnesses testifying in behalf of commissions in rate cases involving a determination of fair rate of return and the inclination of certain regulatory authorities to everemphasize cost of capital as a measure of the fair rate of return. Let us examine briefly some of the techniques used by such witnesses.

Almost invariably the commission witness in such cases makes a statistical study of bond and preferred stock yields, including a study of the yields at which the company's own securities sell. Thereafter, a few tables are offered showing the current earnings: price ratios at which typical utility stocks are selling. The average of such yields may or may not be properly adjusted for selling costs, before the witness accepts such ratios as determining the "cost of common stock capital." These costs, so approximated, are then applied to the capital structure of the company in question to determine the over-all cost of capital to the company. It might be noted in passing that an analysis of the prices at which entire issues of stock are sold by utilities will frequently show up .75 per cent to 1.25 per cent higher than spot earnings to price ratios established by small day-to-day trading and not influenced by the increased supply of stock at the time of an offering for new capital purposes.

In any event, after determining costs of specific segments of capital, the witness applies such costs to the existing capital structure of the company. Thus, a company with 60 per cent debt, 15 per cent preferred stock, and 25 per cent common stock, will have an over-all capital cost of say 5.35 per cent (assuming a 3.5 per cent debt cost, a 5 per cent preferred stock cost, and a 10 per cent common stock cost). This method, if followed to its logical conclusion, has the effect of permanently preventing the company from effecting any improvement in its structure. Even if the 5.35 per cent is earned, the company cannot increase its common stock component without another rate case, for, assume that it tries to increase its common stock component to 30 per cent, then an over-all earnings rate of 5.35 per cent would allow only 8.9 per cent on common stock, an inadequate rate to permit a new flotation of common stock by the witness's own determination.

The method customarily employed by commission witnesses inevitably produces a cost of capital that varies directly with the per cent of common stock in the company's structure.

Let us look carefully at that point. Is there any real reason why the "fair rate of return" should vary for two companies identical in all respects except that of capital structure? Assume for the moment that a "fair rate of return" determination is made for Company A, with a standard or acceptable capital structure. Assume that Company B, similar in all respects to Company A, except in the matter of capital structure, chooses to do a larger per cent of its financing by debt than Company A. Does this mean that the fair rate of return for Company B should be less than for Company A? To be sure, at the same over-all rate of return for both companies the stockholder's investment in Company B produces a higher rate of return (al-



## There Is Still Risk in Utilities

"THE *protection which a proper and balanced capital structure gives to both the senior security holders and to the common stockholders of any company becomes important when its industry is subjected to stresses, either because of fundamental changes affecting the industry or because of a general depression, or both. The mere fact that conditions have been generally favorable to the electric utility industry for a number of years does not eliminate the possibility of unfavorable future developments.*"

though not a higher return in terms of total dollars) than in the case of Company A. But, are not the common stockholders in Company B entitled to a higher rate of return than in the case of Company A because of the higher risk which they have assumed?

A SOMEWHAT similar anomaly exists when a cost of capital study employs the concept that the cost of common stock capital varies with the dividend pay-out ratio of a given company. The thesis has been developed among certain experts that the cost of common stock capital to a utility company may be lowered by increasing the amount of dividends paid relative to the amount of earnings available for common stock; *i.e.,* by increasing the so-called pay-out ratio. There are grounds for disagreeing with the general thesis that utility companies should increase pay-out ratios in order to lower the hypothetical cost of acquiring common stock capital. In fact, what justifiable basis can there be for relating the fair rate of return for an electric utility, or for any other type of utility to its dividend policies? The question of dividend policies should be resolved by the directors of a company on the basis of its capital structure, and a variety of other factors which are related to the stability of the company's earnings and its operations. If a regulatory commission is to make a determination of the fair rate of return to be allowed on the theory that this return should be governed in some way by the dividend pay-out ratio, the commission indirectly substitutes its judg-

ment for that of the directors in the matter of dividend policies.

Let us assume a typical high-grade electric utility, which has outstanding common stock with a book value of $100 a share, which is earning $10 a share, and which is paying a $6 dividend. This stock should sell today at about $110 a share, to yield 5.45 per cent before individual taxes, 3.82 per cent after a 30 per cent individual income tax, or 2.73 per cent after a 50 per cent individual tax. Assume $4 per year is ploughed back for five years and that this accumulated surplus is permitted to earn 10 per cent. At the end of five years, the market value of the stockholder's investment should equal $126.84 a share and should be producing $12.68 a share in earnings. At that time, his stock should have a market value of $139.48 and should be paying $7.60 a share in dividends. His total return over the period would be $53 a share if in the 30 per cent bracket, or $46.22 if in the 50 per cent bracket.[8] If this same corporation had paid out all of its earnings, the stockholder in a 30 per cent bracket would have received over the 5-year period $35; if in the 50 per cent bracket, $25. Thus, if one assumes the sanctity of the utility's surplus—*i.e.*, that it will not be reduced by write-offs, and that it will be permitted to earn a fair return—then the investor should logically value the earnings of a utility with a low pay-out ratio higher than the earnings of a company with a high pay-out ratio, other factors being equal. This is a phenomenon common to industrial stocks and, therefore, is subject to empirical demonstration.

It is apparent from this that an increase in pay-out ratio alone does not affect earnings to price ratios. In the case of the electric utility industry, earnings to price ratios vary inversely with pay-out ratios. A well-known analyst once said: "A liberal pay-out almost invariably results in a higher price for the stock in relation to earnings, which permits the raising of additional equity capital at lower cost." The reasons are twofold: (a) During the past decade only one-third of the capital reinvested for the common stockholders by means of plough-back has actually been retained by the industry, and (b) the common stockholders of typical electric utilities have failed to participate in the great growth enjoyed by the industry. These two facts can be clearly demonstrated.

During the 10-year period 1941 to 1950, all class A and B electric utilities carried a total of $1.4 billion to surplus after common and preferred dividend appropriations. During this same period, however, the combined earned surplus of these companies increased slightly less than $500,000,000. That is, nearly two-thirds of $1.4 billion actually invested by the stockholders through plough-back was written off by various charges to surplus. This situation has undoubtedly developed a lack of confidence among investors relative to the integrity of the investment in utility companies made in behalf of stockholders by way of plough-back.

The electric utility industry today is in a much sounder position than it was

[8] Based on assumption of 60 per cent pay-out ratio applied to annual earnings. Dividends over the period would be at an annual average rate of $6.80.

ten years ago. It should be possible in the next decade to protect the common stockholder's investment in surplus. A reasonable reinvestment should be encouraged, and when the investor's confidence has been re-established, it is reasonable to expect, not an inverse correlation between pay-out ratios and earnings to price ratios, but a direct correlation. The stocks of companies with low pay-out ratios will sell at lower earnings to price ratios, and the industry will be benefited by regular additions to common stock capital without reference to current market conditions and without being required to meet the marketing costs associated with the sale of additional common stock.

Reference has also been made to the failure of the stockholders of electric utilities to participate in the industry's phenomenal growth. One is not required to search far for proof of this unfortunate fact.[4]

A STUDY covering ten of the highest-grade electric utility common stocks (Boston Edison, Cleveland Electric Illuminating, Commonwealth Edison, Consolidated Edison of New York, Consolidated Gas, Electric Light & Power of Baltimore, Detroit Edison, Pacific Gas and Electric, Hartford Electric, Southern California Edison, and Tampa Electric) discloses that a composite investment of $10,000 ($1,000 invested in the common stock of each of these companies) in 1936 had a low value in 1942 of $5,777, and reached a value of $9,356 in 1950. In only one year, 1946, was the average value of the investment above $10,000. In that year, the average value was $10,284. This hypothetical investment in 1936 produced $468.67 in dividends, and in 1950 produced $536.57 in dividends.

In contrast, a $10,000 investment equally distributed over stocks in the Dow-Jones industrial average in 1936 would have never been worth less than $6,483, would have increased to a value in excess of $10,000 in 1945, and would have had an average market value of $13,179 in 1950. (The value today would be about $16,158.) This investment would have produced dividends of $430 in 1936, but would have produced $984 in dividends in 1950. The investor in the utility group would have suffered a 34 per cent drop in the purchasing power of his annual dividends, whereas the investor in the Dow-Jones industrial stocks would have received a 1950 purchasing power

[4] Standard & Poor's utility stock index (1935-39 = 100) shows a low of 62.5 in 1942 and a high of 126 for February, 1952. Compare this with the industrial stock index low of 71.3 and high of 199.1.

¶ "THE *electric utility industry today is in a much sounder position than it was ten years ago. It should be possible in the next decade to protect the common stockholder's investment in surplus. A reasonable reinvestment should be encouraged, and when the investor's confidence has been re-established, it is reasonable to expect, not an inverse correlation between pay-out ratios and earnings to price ratios, but a direct correlation.*"

in terms of dividends equal to 132 per cent of the 1936 dividends.

During this period, the purchasing power of the dollar has dropped just about 50 per cent. Measured by the U. S. Department of Labor wholesale price index, the drop in purchasing power between 1940 and the close of 1950 was 49 per cent; measured by the consumers' price index, 44 per cent. This change in the price level, and its effect on the purchasing power of the dollar, is of significant importance to any consideration of "fair rate of return," not only because of the amplitude of the decline, but because of its rapidity, and more particularly because the decline must be regarded not as a cyclical development but as a permanent development.

UNDER conditions of this nature, it is fair and proper not only to consider the impact of a decline in the value of the dollar on the equity investor in a utility company but to recognize this decline in the fair rate of return:

> The rate-making process . . . that is the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. (Federal Power Commission *v.* Hope Nat. Gas Co.)[5]

Again, in Missouri ex rel. Southwestern Bell Telephone Co. *v.* Public Service Commission, Judge Brandeis in his concurring opinion stated:

> The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business. Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of capital, whatever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital . . .[6]

A "cost of capital" study on conventional lines utterly fails to give consideration to the increase in return required to compensate utility investors for the risk of loss in purchasing power, such as that which has occurred during the past decade. In other words, cost of capital can be disassociated from an original cost rate base only through increasing the per cent return allowance in arriving at a fair rate of return.

IN order to make proper allowance for a fundamental and permanent change in the value of the dollar, in arriving at a "fair rate of return," it is necessary either (1) to relate the required rate of return to some form of cost of reproduction or trended cost rate base, or (2) to determine return requirements in the first instance on the basis of the dollar requirements necessary to meet the test of a fair rate of return without reference to a rate base. If a rate of return on a percentage basis is later desired, this can be computed by dividing "dollar requirements" independently arrived at by a predetermined rate base. Under this procedure, the number of dollars required remains constant. The percentage return will vary in accordance with the type of rate base used as the denominator.

There is, of course, no clear-cut body of law which states unequivocally that an original cost or reproduction

[5] (1944) 320 US 591, 51 PUR NS 193.

[6] (1923) 262 US 276, PUR1923C 193.

## Cost Trending Instead of Reproduction

"SINCE *proper determination of a cost of reproduction rate base is notoriously expensive and time-consuming, a close approximation by applying to an original cost rate base a trending factor or a trending index of cost may achieve 80 per cent to 90 per cent accuracy. Yet such devices are denied validity by some commissions on the pretext that they are not 100 per cent accurate."*

cost rate base shall be used in determining fair rate of return. Legal requirements vary from state to state. Cost of reproduction is controlling or at least required to be considered in arriving at a rate base in some states. In others, the commissions are given latitude in the factors to be considered.

Since proper determination of a cost of reproduction rate base is notoriously expensive and time-consuming, a close approximation by applying to an original cost rate base a trending factor or a trending index of cost may achieve 80 per cent to 90 per cent accuracy. Yet such devices are denied validity by some commissions on the pretext that they are not 100 per cent accurate.

IN view of this reluctance of regulatory authorities to give consideration to cost of reproduction in arriving at a fair rate of return, it is therefore frequently advisable, as previously suggested, to develop a basis for determining the number of dollars which the company should be permitted to earn in order to meet operating costs, including depreciation and taxes, costs of senior capital, and a return for the common stockholder. This return for the common stockholder should be sufficient not only to attract additional capital on fair terms, appropriately divided between fixed-charge capital and common stock capital, but sufficient to provide the common stockholder with a return adequate to compensate for the risks attached to his investment (including the risks of a decline in the purchasing power of the dollar), and commensurate with returns in other enterprises having corresponding risks. What are these returns?

The natural gas industry, based on the record of companies reporting to the Federal Power Commission, averaged to earn 7.04 per cent on average

invested capital for the years 1946-1950, inclusive, and 11 per cent on common stock capital. Twenty of the largest and most representative industrial companies averaged to earn 9.2 per cent on over-all average invested capital for the period 1932-1950, inclusive, and earned in excess of 5 per cent in all except three years. For the period 1946-1950, inclusive, this group of companies earned 14.1 per cent on average invested capital. The return on equity capital was at a much higher rate. For the period 1946-1950, inclusive, the electric utility industry earned 6.3 per cent on over-all average invested capital, although many companies during this period failed to earn 6 per cent. A cost of money study indicating an over-all cost of capital of 6 per cent or less evidently fails to give the stockholder of an electric utility company a return commensurate with the rate earned in other enterprises after proper adjustment for risk.

THERE are other elements in the fair rate of return which are not adequately provided for in a cost of capital determination. During a period of rising prices, particularly during a period of rapidly rising prices, plant additions made subsequent to a rate determination are placed on the books of the company at values higher than those at which existing plant units are carried. As a result of this situation, the rate base or dollar investment in plant is increased more rapidly than is its capacity to produce revenues at existing rates. As a result, such plant additions as are made subsequent to a rate determination dilute the return on the composite rate base. In fact, it frequently happens that at existing rates for service, new or added plant may earn no more than 2 per cent or 3 per cent.

Other elements of cost also continue to increase, resulting in failure on the part of the utility to achieve for any period of time the allowed rate of return. Thus, unless some allowance is made for (1) the tendency for costs to increase over and above estimates or projections, and (2) the inevitable lag between the filing of an application for increased rates and the granting of such increase, the utility is likely, for continued periods of time, to earn less than the fair rate of return found by the commission. This may be restated by saying that *a return allowance limited to the cost of capital will probably produce, over any extended period, an average return even below the cost of capital.*

THIS situation has a "double-barreled" effect on the financial operations of the utility. The most obvious effect, of course, is to restrict the common stockholder to a return even below the determined cost rate for equity capital. The more insidious effect is the impact which this situation has on the capital structure of the utility. The cost of money determination in the first instance is usually geared to the existing capital structure of the company. The fallacy of not gearing a cost of money study to an "appropriate capital structure" has already been discussed. In the recent Illinois Bell Case the commission's witness insisted that company subscribers were entitled to economies accruing from the present higher debt capital. The commission agreed that "economy in capitalization was as much an obligation of a public

utility as economy in operation," indeed a dangerous concept, since it transfers to the commission final determination of what is a proper debt ratio. The Illinois commission in this case found that the average cost of capital to the Bell system had dropped from 6.17 per cent in 1935 to 4.83 per cent in 1951, and denied the company's petition for a rate increase in toto.

The effect of this reasoning can be illustrated by the table below.

This company, in the course of the following year, we will assume, adds $100,000 of new plant to its rate base, temporarily financed by bank loans, and experiences an increase in expenses, with the combined result that the over-all rate of return actually earned is equal to only 4.50 per cent on the new rate base of $1,100,000. With the return on the common stock component now reduced to 9.50 per cent,[7] before issuing additional stock, it is obviously impossible to sell additional common stock on terms equitable to the existing stockholders. Under these conditions, it is but natural that the company should resort to additional debt or preferred stock financing, still further impairing the company's capital structure. This is a simple illustration, but it explains why many utilities are prevented from improving their capital structures and, in fact, are forced further to impair their capital structures because of inadequate earnings.

At this juncture, one may well raise the question: What is a proper capital structure for an electric utility? Unfortunately there is no clear-cut answer subject to statistical demonstration. The average or composite capital structure of all class A and B electric utilities at December 31, 1950, comprised 48.87 per cent debt, 13.70 per cent preferred, and 37.43 per cent common stock and surplus. The common stock and surplus component has remained at about this level since 1938.

It is easy to argue that the electric utility industry is today in a very strong position in view of the high demand for electric energy. It is frequently stated that electricity at present rates is an underpriced commodity, and that, because of this fact, commissions can always control the earnings of electric utility companies through rate adjustments. There is, it is claimed, no danger of pricing the commodity out of any part of its market under this set of circumstances. Certainly the facts of the situation superficially substantiate this opinion. Since

[7] Gross Income $1,100,000 x 5% = $55,000; Less: Bond Interest $29,250, Bank Interest @ 3%, $3,000; Preferred Stock Dividends, $9,000; Total, $31,250; equals $23,750 for $250,000 Common Stock, or 9.5%.

ASSUMED CAPITAL STRUCTURE AND COST OF MONEY DETERMINATION FOR AN HYPOTHETICAL UTILITY COMPANY

| *Total* | *%* | *Type of Capital* | *Cost Rate* | *Cost Per $100* |
|---|---|---|---|---|
| $ 550,000 | 55 | Bond Capital | 3.50% | $1.925 |
| 200,000 | 20 | Preferred Stock Capital | 4.50% | .900 |
| 250,000 | 25 | Common Stock Capital | 10.00% | 2.500 |
| $1,000,000 | | Over-all Cost Rate Per $100 | | $5.325 |
| | | Allowed Return, 5.35%, or | $53,500 | |

1940, the consumers' price index on an over-all basis has advanced 89 points, the gas and electricity rate index has *declined* 3.2 points.

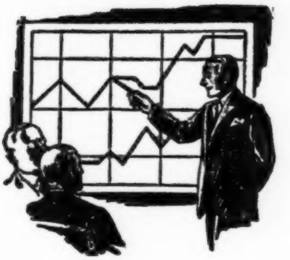
THE protection which a proper and balanced capital structure gives to both the senior security holders and to the common stockholders of any company becomes important when its industry is subjected to stresses, either because of fundamental changes affecting the industry or because of a general depression, or both. The mere fact that conditions have been generally favorable to the electric utility industry for a number of years does not eliminate the possibility of unfavorable future developments. The railroad industry, after experiencing three-quarters of a century of growth, suddenly found itself confronted with competition from pipeline companies, trucks, automobiles, and bus transportation in the decade 1920-1930. Before the end of the decade 1930-1940, over one-third of the country's mileage was being operated under receivership. The traction industry is now experiencing hard times with no relief in sight. The gas industry would undoubtedly be in a serious condition today, except for the introduction of natural gas.

Who can say that the present tempo of scientific advance definitely does not open the possibility of developing new forms of energy which may prove competitive to the electric utilities?

Fixing a fair rate of return is not an abstract mathematical process, but rather one in which the consumer and investor interests are both weighed. The result of this process should meet the following test questions:

1. Out of fairness, and without reference to the market's temporary inability to price out all the risks of inadequate dividend coverage, what earnings requirements are necessary to permit a utility to pay adequate dividends to its common stockholders and still provide an adequate cushion or coverage over and above dividends actually paid?
2. Again, and without reference to the market's temporary failure to price out fully the risks involved in an inadequate capital structure, what earnings will the utility require to sell sufficient common stock to achieve at least a minimum standard of capital structure?
3. To what extent should the utility common stockholder be afforded protection against the depreciation which his dollar investment has suffered as a result of inflation?
4. To what extent should the common stockholder of a utility, who has furnished all of the risk capital, be permitted to participate with the customer in the phenomenal technical advances made by the industry? A definite question of weighing consumer and investor interests.

THE men who represent both the consumer and the investor on regulatory bodies are thoughtful, patient, and, I believe, are sincerely desirous of arriving at the proper answers to the foregoing questions in rate cases. At least this has been my experience and I have been before many different commissions, both on behalf of commissions and on behalf of applicant companies. A most important task in rate cases is to get the more fundamental issues related to rate of return clearly spelled out, and distilled from a morass of less meaningful statistics.



IMPACT OF PRICE LEVEL CHANGES ON

# Utility Depreciation Costs

## *Part II. Accounting Developments Relating to Price Level Changes*

***The argument that accounting does not need to give recognition to changes in the price levels is carefully but critically examined. Here is an analysis of the impact of price level changes on depreciation costs of public utilities.***

BY PAUL GRADY*

IN a recent rate case proceeding, Dr. George Terborgh, director of research of the Machinery and Allied Products Institute, presented charts and tables to show for all manufacturing corporations the rate of return on equity capital from 1926 to 1951, both before and after the inventory, plant, and depreciation adjustments resulting from price level changes. I have made one combined chart (No. 4, page 37) from his data to show the ratios of return before and after the adjustments; the differences between the two represent the effects of the change in price levels.

It will be noted that after 1946, the first postwar year, the adjusted rate of return of all manufacturing corporations compared favorably with that enjoyed in the late 1920's and was better than the average return for the prewar period 1937 to 1941. The chart demonstrates rather clearly that in unregulated industries market forces provide substantial protection against inflation. Even so, the substantial overstatement of reported income, under present accounting methods, as compared with economic income may cause the funds required for inventory and plant replacements to be diverted to taxes, wages, and dividends to the ultimate detriment of our economic welfare. The decreasing ratio of real profits to real capital investment in 1951 may well be a reflection of such a trend.

REGULATED utilities have no protection through market forces from the effects of inflation, because the price of their services is controlled by regulatory commissions and they must

*For personal note, see "Pages with the Editors," June 19, 1952, issue, page 6.

build plant in advance of load requirements regardless of the prospects for a favorable return on the added investment. The provision for plant exhaustion is also of greater importance to utilities than to commercial enterprises because of the higher relative ratio of plant investment to annual revenues. An indication of the magnitude of the problem to the electric utilities is shown in the estimated results for the year 1951 presented in the tabulation labeled Table II (page 33).

The so-called historical results are taken from the preliminary estimates of the Edison Electric Institute. The current dollar results are after increasing depreciation $271,000,000 of which $245,000,000 is applicable to electric plant and $26,000,000 is applicable to other utility plant owned by class A and B electric utilities. The adjustment of depreciation, amounting to slightly more than 50 per cent of the original cost provisions, is undoubtedly on the low side for two reasons; first, the consumers' price index of the Bureau of Labor Statistics used to convert the property and depreciation accounts to current dollars is lower than utility construction price levels, and, second, utility plant accounts were not aged by year of installation prior to 1941, all of such property being converted on the basis of the 1940 index.

THE ratio of gross income, with depreciation on an original cost basis, to average capitalization as shown by the accounts was 5.72 per cent for the year 1951. After adjusting the gross income and the capitalization to current dollars, the real earnings ratio is only 3.01 per cent. In the previous chart (No. 4) the ratios of profits to equity capital for manufacturing companies were given and in the year 1951 the historical ratio of 12 per cent was reduced to 7 per cent after adjustments to state the profits and equity capital in current dollars. If the electric utilities are viewed in the same manner, the ratio of historical income for 1951 to the book equity capital at January 1st was 9.86 per cent, and after adjusting income and capital to current dollars the ratio of real earnings to real capital employed would be reduced to 4.01 per cent.

*Primarily a Regulatory Problem for Utilities*

THE matter of providing for property exhaustion on a current cost basis in industrial enterprises is largely in the area of financial and accounting judgment. In the case of utilities, however, the additional depreciation costs must be allowed and recovered by revenues from customers in advance of accounting recognition. I believe that, next to the threat of socialization, the maintenance through revenues of the integrity of the physical capital in terms of service capacity is the most important problem faced by utilities under present political and economic conditions.

The philosophy of regulation, as I understand it, encompasses three goals: to protect the rate-paying public from unreasonable charges; to see that the investing public is fairly compensated; to insure that the utility, as a public servant, shall be at all times able to meet its responsibility of providing adequate service to the public. The last goal really involves the public welfare to a greater degree than the others and it is this objective which is seriously

threatened by the effects of inflation.

The three interests thus contemplated, although essentially inseparable, are superficially at odds with one another. In the long run, a well-served public should view its servant benignly and encourage it to prosper. A prosperous utility means a satisfied investing interest; ready availability of investors' funds means an unimpaired growth and improvement of facilities to meet consumers' demands. The short-range interests, however, seem to conflict sharply; the ratepayer would readily accept service below cost; the investor seeks the largest compensation

TABLE II

ELECTRIC UTILITIES IN THE UNITED STATES

Income Statement

Year Ending December 31, 1951

(In Millions of Dollars)

| | *In Current Dollars* | *In Historical Dollars (Preliminary Estimate By EEI)* |
|---|---|---|
| Revenues | $ 4,960 | $ 4,960 |
| Operating expenses | 2,367 | 2,367 |
| Depreciation | 725 | 480 |
| Taxes | 1,137 | 1,137 |
| Total revenue deductions | 4,229 | 3,984 |
| Electric operating income | 731 | 976 |
| Income other departments before depreciation | 129 | 129 |
| Depreciation | 76 | 50 |
| Income from other departments | 53 | 79 |
| Other income | 65 | 65 |
| Gross corporate income | 849 | 1,120 |
| Interest long-term debt | 284 | 284 |
| Amortization and other deductions (net) | 24 | 24 |
| Total deductions from gross income | 308 | 308 |
| Net income | $ 541 | $ 812 |
| *Plant and Capitalization* | | |
| Utility plant | $35,658 | $23,600 |
| Depreciation reserve | 7,199 | 4,765 |
| Capitalization | 29,958 | 20,334 |
| *Earnings Ratios* | | |
| Ratio gross income to average capitalization | 3.01% | 5.72% |
| Ratio of current dollar gross income to average historical dollar capitalization | 4.34% | |

Note: Plant and depreciation adjustments to reflect current dollars are based on monthly averages of consumers' index—Bureau of Labor Statistics. No adjustments made for price level changes prior to 1940.

he can; management would naturally provide for "a rainy day." Unfortunately, also, some decisions indicate that the commissions and the courts mistake the consumer viewpoint, portrayed by some clever lawyer with maximum use of the press, as synonymous with the public welfare.

LET us examine the real effect of inflation and of allowance only of depreciation on original cost on the three basic interests of utility service and regulation. Before doing so, I should like to make clear that I recognize inflation levies a heavy toll on the past savings of a considerable part of the people and its application is bound to be highly inequitable, depending upon the form of the particular individual's savings. This brief is not directed at relieving the levy of inflation imposed on the utility investors, because all investors in fixed income securities are in the same boat; this argument is directed solely to the question of what course of action is required to serve the real public interest.

The war and postwar inflation have taken away a very large portion of the purchasing power of income received by investors in public utility securities. This loss applies to the common stockholders as well as preferred stockholders and bond owners, because effectively the return on utility common stocks is fixed within relatively narrow limits. The capital value of this levy on the investors in electric utilities in current dollars is more than $9 billion. This entire capital levy has been taken from the investors and given to the customers of the electric utilities because in the aggregate the electric utilities are earning at a lesser rate on historical capitalization than they did in 1940. This shift, which has also occurred in gas utilities, is one of the many inequities of inflation. Utility consumers have no equitable rights to such a windfall because recent statistics show that disposable personal income is greater even in constant dollars than it was in 1940. All of this has been pointed out to portray part of the effect of inflation; however, I am not at this time proposing that anything be done about it because it involves the compensation for use of capital and this discussion is limited to the issue of who should pay for the maintenance of the integrity of the physical plant in terms of capacity for service.

AS previously demonstrated (Table II), the allowance for depreciation of electric utilities in 1951 was $271,000,000 less than required to state the property exhaustion costs in current dollars. The effect is to assign this further substantial annuity to the benefit of current electric customers. Such annuity will extend over the remaining life expectancy of the properties in service and will increase if inflation continues, as seems to be the intention of those now in control of our government, because inflation is a process of debasing currency which cannot stop unless the basic causes are removed.

Failure to allow for property exhaustion costs in current dollars constitutes an unjustifiable gratuity to present customers to the detriment of future customers, as well as equity investors, and creates a grave risk of impairing the ability of the utilities to meet their responsibility of providing adequate service to the public. The

## Putting an Honest Label on Regulatory Policy

*"IF the investors who furnish equity capital of utilities bear all risks inherent in a rate base, which is original cost or value, whichever the lower, they should be apprised of that fact. In this way the rate of return required to attract new capital will find a proper level. Even under such a harsh philosophy of regulation, in my view it is manifestly unsound and contrary to the real public interest to place the further burden of maintaining the existing capacity of plant on equity investors instead of the users of the service."*

support for this statement is presented in succeeding paragraphs.

THERE are many approaches to the regulation of rates and the Supreme Court of the United States has thrown out all requirements of methodology so long as the so-called "end results" do not bring about obvious confiscation. The latitude, and therefore the corresponding responsibilities of the commissions, to find sound patterns of regulation, are very wide. In the treatment of depreciation, the most extreme view would be to disallow all depreciation and, under this method, there would have to be ironclad covenants that the rate base would never be less than the capitalization. This scheme would be grand for the first cycle of customers but it would be awfully rough on future customers. If they have the right to vote, there is little question that the system of regulation would be changed rather early in the second cycle of customers.

In a period of inflation the original cost depreciation method of regulation is midway between allowance of no depreciation and allowance of enough to maintain the integrity of plant capacity devoted to the public service. This, of course, represents quite an improvement over the first method, but it should also be accompanied by strong assurances that the rate base will never be less than the cost of the property in service. Apparently it is the view of Charles W. Smith, chief of the bureau of rates and accounts of the Federal Power Commission, that such assurances have been established in the present pattern of rate making. In his dissent in the report of the Study

Group on Business Income, he said:

> Utilities, in particular, under the investment principle of rate regulation, should adhere to the cost basis of stating depreciation expense. Under the investment principle of rate regulation, when the additional investment is made it is protected through the allowance of a fair return thereon plus full depreciation. This is a practical method in that it avoids guesswork and at the same time fully protects the investment, whatever it may be, when made.

THE foregoing is an unequivocal statement but my faith in the firmness of the regulatory covenant is shaken by the following excerpts from the 1949 report of the committee on valuation of the National Association of Railroad and Utilities Commissioners:

> While net investment, when correctly determined, is generally considered to be the most reliable single criteria in arriving at such a rate base, neither the continued soundness of investments nor the continued furnishing of capital earnings can be guaranteed by the customers of the utility. To do so would remove all element of risk and leave no excuse for higher earnings on risk capital than on bonds. The utility investor must meet the competition of progress in the art and cheaper sources of power. Many cases can be cited where investments, sound at one time, eventually depreciated in value.
>
> Nevertheless consideration should be given to present-day values in arriving at a rate base and reasonable earnings on such base if justice is to be done in all cases. Such consideration may be given either directly in establishing the rate base or indirectly in fixing the rate of return. For example, assume two municipalities "a" and "b" of similar characteristics served by the same telephone utility, but with separate exchanges. Before World War II the utility found that it would be advantageous to rebuild both exchanges, replacing the old equipment with new equipment of improved design. Only one exchange could be replaced at a time. At the option of the utility, exchange "a" was replaced first at low prewar prices but it developed that exchange "b" could not be replaced until after the war and then at high postwar prices. In such a case, since the time of construction of the first exchange was at the option of the utility, over whose choice the subscriber had no control, there would be considerable justification for the same rates at each exchange. However, to fix the same rates for each exchange would require a rate base higher than net investment at one exchange and a rate base lower than net investment at the other, or corresponding differences in their respective rates of return.
>
> Under the same set of circumstances, except that the two exchanges were under different ownership and one of the owners decided to rebuild earlier than the other, there would likewise be considerable justification in fixing reasonably comparable rates at each exchange. Such rates could be justified perhaps by giving consideration to the normal or average level of construction costs as contrasted to the high and low costs experienced by the two utilities in question. . . .

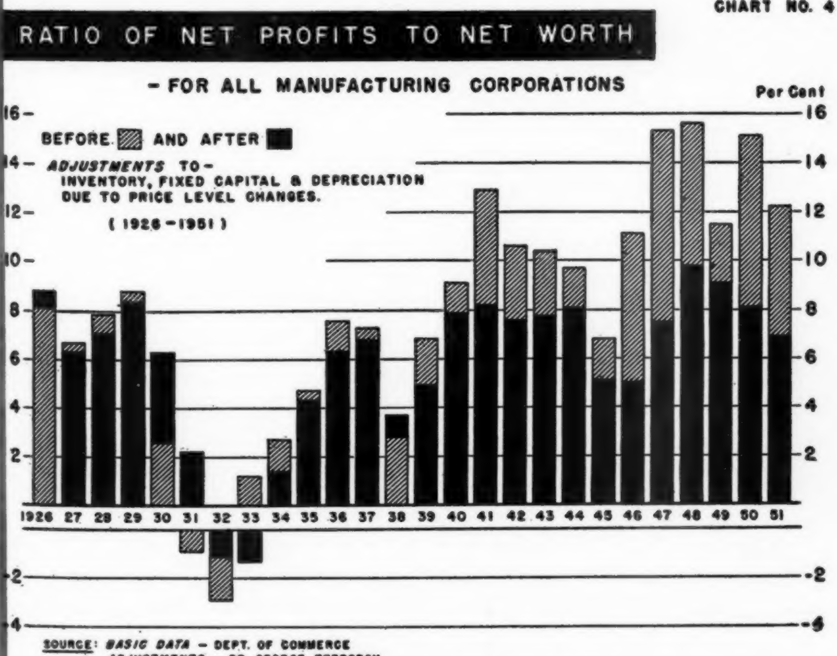
PERHAPS it was merely coincidence that the foregoing was written by an important regulatory committee in the only year since 1940 that showed even slight decline in price levels. However, great trustfulness is required to believe that the so-called investment principle of rate regulation will protect a fair return on investment plus full depreciation should the price level ever fall below the level of original cost. Experience tells us, through the two shifts already made in the history of regulation, that the customers would quickly bring about a return to a "fair

value" doctrine. It is easy to imagine the resounding phrases of censure to utility managements for negligence in not charging past customers enough to cover exhaustion of property in terms of the price level prevailing at the time the service was rendered. In such circumstances, hindsight might make it seem perfectly clear that part of the then unsatisfactory position of the equity investors was due to the overstatement of earnings and the resultant payment of dividends out of economic capital in the past period of inflation.

If the investors who furnish equity capital of utilities bear all risks inherent in a rate base, which is original cost or value, whichever the lower, they should be apprised of that fact. In this way the rate of return required to attract new capital will find a proper level. Even under such a harsh philosophy of regulation, in my view it is manifestly unsound and contrary to the real public interest to place the further burden of maintaining the existing capacity of plant on equity investors instead of the users of the service.

Official answers to these issues can come only from the commissions and the courts. It seems to me that the present disparity between original cost depreciation and an adequate charge for property exhaustion in terms of current dollars is so great that utilities

CHART NO. 4




SOURCE: BASIC DATA – DEPT. OF COMMERCE
ADJUSTMENTS – DR. GEORGE TERBORGH
Director of Research, Machinery and Allied Products Institute.

cannot afford to rest until they have determined such answers. The Supreme Court, in the Hope Natural Gas Company Case,[1] upheld the propriety of basing depreciation on cost and stated "By such a procedure the utility is made whole and the integrity of its investment maintained." However, the purchasing power of the dollar has been substantially impaired through inflation since the decision was rendered in January, 1944, and it can be demonstrated that under present conditions original cost depreciation will not maintain the integrity of the capacity of the plant for service, which is the substantive issue.

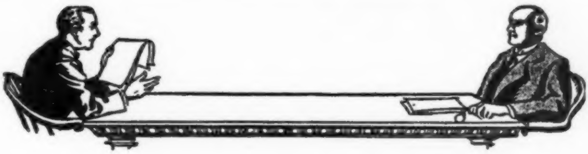
Two arguments, at least, will be advanced by regulatory personnel opposed to charging present customers for current dollar cost of property exhausted in service; first, that increased efficiency of new equipment is a proper and effective offset to the effects of inflation, and, second, that allowance of depreciation in excess of original cost would constitute unjust enrichment to the equity stockholders.

No one can deny that there has been, and we hope there will continue to be, great improvement in the construction and operating efficiency of utility equipment. If original cost depreciation could, in fact, maintain the capacity for service of the utility plant, I would agree that no additional provision is required. However, an objective analysis of the facts will demonstrate that it just isn't so. Furthermore, it should be borne in mind that price level indices themselves reflect the results of improvements in efficiency. In fact, production improvements have been our only protection against the ravages of rampant inflation.

The greatest technological improvements in the utility field probably are in the area of steam generation electric plants. I had occasion just recently to study two plants owned by the same company; the first had been constructed over the period 1933 to 1945 at a composite cost of $86 per kilowatt of capacity; and the second had been constructed in 1949 and 1950 at a cost of $146 per kilowatt of capacity. Thus the cost of the newer station in terms of capacity to serve was 70 per cent higher than the older station. In regard to the differential in operating efficiency, I do not believe it is sound regulation or economics to give present users the benefit of anticipated operating economies of the future. They belong to and will be received by future users. Present users, as a general proposition, already are receiving the benefits of the technological and efficiency improvements realized to date. This is true because the newer plants, of course, are used to carry the base load and the older, less efficient plants are used to supply the peak-load requirements.

By weighing both capital costs (*i.e.*, the charges for new capital) and the operating costs, a balanced system of new and old plants provides the service requirements with greater economy than if all the plants were new. When this ceases to be the case, a new plant is built and the least efficient plant is removed from service. It seems to me that the proper conclusion is that anticipated efficiencies, beyond those automatically reflected in the appro-

[1] Federal Power Commission *v.* Hope Nat. Gas Co. (1944) 320 US 591, 51 PUR NS 193.



## No Windfall in Utility Securities

*"THE claim of unjust enrichment is usually based on the premise that the utility equity stockholders will somehow fall heir to the inflation levy which has been imposed on the owners of senior securities. If a full rate of return were allowed on reproduction values of the utility properties the claim would have some validity, but it is difficult to see how the over-all 5.72 per cent estimated return on average historical capitalization for the year 1951 indicates even the suggestion of such a condition."*

priate price indices, have no bearing whatever on the increase in revenues required to cover property exhaustion costs in current dollars, but may have a material bearing on the estimated lives of the properties, which is the basis of determining the annual depreciation rate.

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Utility properties are permanently devoted to the public service; the separate property units cannot be distributed in kind to stockholders so there is no danger of transformer and pole dividends comparable to the liquor dividends of the war period. Furthermore, the commissions have ample authority to assure that dividend distributions will not be made out of funds arising from property exhaustion provisions. All of these protections should make it obvious that there can be no unjust enrichment to stockholders through allowance of property exhaustion costs in current dollars.

The essence of the problem is the maintenance of the plant in terms of service capacity which cannot result in a gain if income is defined in accordance with sound economic concepts. As has been previously pointed out, the levy of inflation has applied to equity securities as well as the senior utility securities and the present customers are the beneficiaries.

SOME people say that accounting is a poor and hopelessly inadequate

tool to attempt to measure or deal with the effects of inflation in the determination of business income. That this is not the case is amply demonstrated by a century of providing for property exhaustion on the basis of estimated costs of replacement by the British railroads prior to nationalization in 1948. Since nationalization the equipment is being carried and amortized partly on the basis of actual cost, and partly on the basis of 1948 prices.

However, the Transport Authority recognizes that this leaves a deficiency to meet the estimated cost of replacement and states that this deficiency will be made up at least in part when sufficient earnings are available. The authority for the gas industry in Great Britain also recognizes that the burden to be borne by revenue is that of maintaining the enterprise—not only of amortizing the cost of what has been invested The reports of the Electricity Authority are not clear on the point, but it is interesting to note that the total annual provisions to property reserves are more than 4 per cent of the total gross investment in utility plant, including land. Furthermore, in recent rate proceedings in England, regulatory tribunals have made specific allowances for the excess of cost of replacement of property over the amount invested.

To sum up this presentation, the arguments against allowance for property exhaustion in terms of current dollar costs for public utilities briefly stated are: first, that increased efficiency is a proper and complete offset to changes in price levels, second, that such allowance would result in unjust enrichment to stockholders, and, third, that the accounting process is not capable of handling property exhaustion charges in terms of current price levels. It is clear that none of these arguments can stand up under objective analysis. On the other hand, failure to maintain the real physical capacity of utility plants out of revenues results in serious hazards to all of the basic objectives of utility service and regulation. It causes service to be rendered at less than true current cost and thus forces a substantial part of the return to equity stockholders to be paid from economic capital. The imposition of this further burden of raising new equity capital for part of the replacement of present plant in addition to the financing of additional plant capacity creates unwarranted risks that the utilities may not always be able to meet the demands for service.

Furthermore, it is doubtful that the real interest of customers is served by charging less than economic cost during a period of inflation, since the practice necessarily involves the moral, if not legal, obligation of paying a reasonable return on the increased capitalization. If the problem were understood, I believe many customers would rather pay currently 3 per cent as depreciation on the differential between original cost and current cost, than to incur the increasing obligation to pay 6 per cent as return on the full amount of new capital required to maintain the current capacity of the plant.

# Washington and the Utilities

## *Power Issue Popping*

THE public power issue was featured in three important developments in Washington during the past week. The most spectacular was the action of the Senate in voting (43 to 40) to kill the St. Lawrence seaway and power project for the present session by sending it back to the Foreign Affairs Committee. Canada will now probably go ahead alone, or in collaboration by compact with Great Lakes states acting independently of the Federal government. New York state stands a good chance of getting the FPC to reconsider its license to generate St. Lawrence power in conjunction with Ontario.

The other two developments were (1) the unanimous vote of the House Reclamation Subcommittee to postpone action on the controversial bill to authorize Hell's Canyon dam on the Idaho-Oregon border; and (2) the introduction of the Magnuson Resolution (SJRes 168) which calls for a Federal Trade Commission investigation of alleged public utility propaganda, publicity, advertising, etc., for three years, with reports every thirty days. Eight Democratic Senators joined with three irregular Republican Senators on this proposal. But the outlook is for no action this late in the session.

## *No Utility Seizure Law in Sight*

MORE or less sophisticated political observers are wondering just what President Truman had in mind when he asked Congress for seizure authority legislation following the historic decision by the U. S. Supreme Court, outlawing his action in the steel dispute.

The President could not have been surprised, therefore, when the Senate successively voted down seizure authority proposals by Chairman Maybank (Democrat, South Carolina) of the Senate Banking and Currency Committee and Senator Morse (Republican, Oregon) and thereafter approved the Byrd resolution requesting the President to invoke the Taft-Hartley Act. What then was his objective? Consensus seems to be that he was simply playing out his cards after losing the court decision.

Both the President and the court have now placed the responsibility for providing seizure authority, in cases of grave emergency, squarely in the legislative branch. This is where public utility interests are at stake.

PUBLIC utilities have some reason to be thankful, therefore, that Congress resisted the temptation to rush through what might have been blunderbus legislation which could be used at a later date against the utilities by an administration which is increasingly antiutility.

Heretofore, government operation of "seized industries"—such as the railroads during the past two years — has been a nominal form of caretaker management. But there is some fear in Congress that a definite and continuous statutory authority for such Federal management might be subject to future abuse or collusion between the executive branch and special segments of the economy. The present outlook is for no quick congressional action on seizure power for the President.

## *A New Tidelands Grab?*

OIL and gas industries are still rubbing their eyes over the revelations made by Senator Holland (Democrat, Florida) during the recent congres-

sional struggle over President Truman's veto of the tidelands bill. Holland accused the Interior Department of intending to "grab" the disputed tidelands by executive order and administer them under the 1949 Federal Property Act. General Services Administrator Larson, who administers that act, admitted the existence of an "exploratory" order delegating authority over the tidelands to Interior Department. Interior Secretary Chapman conceded that he has a plan to lease the tidelands for oil and gas development but that it has not yet received the approval of the President. Senator O'Mahoney (Democrat, Wyoming), who usually supports Interior, disagreed with Chapman's idea that the Federal Property Act could be used in this way. The Senate Judiciary Committee, headed by McCarran (Democrat, Nevada) promised a thorough inquiry.

If Holland's charges are true, it could mean that Interior is getting set for business in offshore oil and natural gas deposits. Anticipating that the administration's position (as to paramount Federal interest) will be sustained, Secretary of the Interior Chapman has doubtless been organizing a licensing program to go into operation as soon as the current controversy over tidelands legislation subsides.

In the beginning, such Federal operations would probably be on a licensing basis. Private companies seeking to develop offshore gas and oil deposits would have to come to Interior for the necessary documents. Such licenses would, of course, be subject to Interior's conditions and regulations—including common carrier status for pipelines. Over the longer range, however, if not enough private companies apply for licenses, there is already some speculation that Interior may one day seek authority for direct government development. So far this is only a paper plan and already has stirred opposition in Congress. It is a little difficult to imagine in the present critical atmosphere, but if the administration or its policies win a vote of confidence next November, such a program could materialize.

Senator Holland's revelations gave support to warnings by the advocates of state ownership that Federal control over the tidelands would lead to the government's entrance into the oil and natural gas business. Consequently, a ruling, soon to be made by the U. S. Court of Appeals for the District of Columbia, merits special attention of oil and gas industries.

Last summer a lower court ordered Chapman to issue the El Paso Natural Gas Company a permit to build a pipeline across public lands. Chapman had previously refused (although the pipeline was almost completed) because the company would not accept a "common carrier" provision. On appeal the company asked for a broad ruling on Chapman's contention that he may *at any time* attach limitations and conditions (including common carrier status) to a construction permit. Such authority, if upheld, would tend to discourage private company license applicants.

## *Appropriation Bills in Congress*

The Agricultural Appropriation Bill (HR 7314) is in House-Senate conference for the purpose of ironing out certain differences on amount of funds allotted to various bureaus of the Agriculture Department. Funds for the Rural Electrification Administration electric and telephone loans encountered no dispute.

Under this bill (for fiscal 1953), the REA gets an outright appropriation of $50,000,000 for electric loan purposes, and $25,000,000 for loans under the rural phone program. In addition, two contingency funds were allowed which may be drawn upon at the request of the Secretary of Agriculture. These "contingency funds" contain an additional $50,000,000 for power loans under the REA program, and $10,000,000 for rural telephone loans. A spokesman for REA hinted that the agency expects to be back

for supplemental funds before the end of the calendar year.

Another bill soon to emerge from House-Senate conference with little change was the Independent Offices Appropriation Bill (HR 7072) carrying funds for Federal regulatory agencies and government corporations. This measure includes the following agency funds: Atomic Energy Commission, $1,137,727,500; Federal Communications Commission, $6,708,460 ($600,000 more than the House); Federal Power Commission, $4,235,700 ($300,000 more than the House allowed); Securities and Exchange Commission, $5,245,080; and Tennessee Valley Authority, $186,027,000 ($14,757,000 more than House).

The bill, as passed by the Senate, deletes House-approved language directing TVA to require the performance bond in connection with coal purchase contracts. The large Senate increase for TVA represents Senate approval of two additional units for the Shawnee steam plant at Paducah, Kentucky.

THE McKellar Bill (S 97) to authorize power facilities at Cheatham dam on the Cumberland river (Tennessee) has been cleared for the President's signature. The project was originally authorized for flood-control and navigation improvement. As a result of the passage of the McKellar Bill, $18,200,000 is now authorized for construction of a power plant. The bill passed the House by a vote of 132 to 120 early this month. It passed the Senate in October, 1951. Enactment will permit the funds to be appropriated by the Senate Appropriations Committee, which is currently drafting the final version of the Army Civil Functions Appropriation Bill (HR 7268). The bill was promoted on the basis that the additional power is needed by defense plants. It will be distributed via the Tennessee Valley Authority.

## *Roanoke Rapids Dam Delayed*

WORK on the Virginia Electric & Power Company's $27,000,000 hydroelectric power plant at Roanoke Rapids, North Carolina, has been suspended, Jack G. Holtzclaw, president of the company, announced recently. Holtzclaw said that only a topographic survey of the plant site and area would continue, and even that would be suspended by the end of this month.

The announcement came after the Federal Power Commission in Washington, acting on a petition of the power company, authorized the stoppage of work pending a decision by the United States Supreme Court on the appeal of the Secretary of the Interior challenging the right of Vepco to build the plant. Secretary Chapman is fighting the case in the courts on the ground that the government should build the plant rather than Vepco. The company won the first two rounds in the legal battle—in the district court in Baltimore and in the court of appeals, both of which upheld the permit granted by the commission to the utility.

## *Interstate Area Transit Commission?*

SOMETHING new in the way of a regulatory body would be provided for in a bill recently approved by the Senate Commerce Committee for transit regulation in the Washington metropolitan area. Committee Chairman Johnson (Democrat, Colorado) announced that his group had approved the bill "practically unanimously." The measure is now on the Senate calendar.

The legislation is the outgrowth of repeated demands for better co-ordination of public transit facilities in the metropolitan area. The measure was introduced by Senator Johnson after public hearings last month on other legislation looking toward improvement in transit service in the District of Columbia.

The bill provides for a commission of three members appointed by the President and subject to Senate confirmation. They would represent the District, Maryland, and Virginia.

# Exchange Calls And Gossip

## *REA Clarifies Area Coverage*

THE Rural Electrification Administration has issued an administrative bulletin clarifying certain aspects of area coverage provisions in rural telephone loan contracts. The policy statement explains that the boundaries of the telephone service area shall be determined initially by the borrower, "having due regard to the inclusion of all farms and other rural establishments requiring telephone communications with their trading and community centers and with each other." Generally, loans shall be made for the purpose of providing adequate telephone service to all persons within the telephone service area who desire it. However, if it is found to be impractical to accomplish this result as a single project with one loan, consideration may be given to a loan application relating to only a portion of the area.

Where the loan application relates to only a portion of the telephone service area, which shall include a proportionate share of the less desirable territory, the borrower will be required to explain the reasons for selection of the partial area, show that the proposed development is consistent with ultimate extension of service throughout the entire telephone service area, and present a plan for extending service to the entire area. Loans will not be made to provide service to only a portion of the telephone service area unless the proposed development is consistent with ultimate extension of service throughout the entire area.

Where the telephone service area is partially within the boundaries of any incorporated or unincorporated city, village, or borough having a population in excess of 1,500 inhabitants, the borrower will not be required to include such nonrural portions of the area in its program for area coverage development. This shall be true regardless of whether or not the application requests funds for financing the construction or improvement of facilities located within such nonrural areas and that request is justified on the basis that it is necessary in order to furnish or improve service in rural areas.

BORROWERS will have the responsibility of ascertaining the demand for telephone service in their service areas as a basis for REA appraisal of the degree of area coverage to be accomplished. In addition, the borrower must supply REA with the information as to the means whereby such demand or absence of demand was determined.

The borrower will be obligated to provide such facilities as may be necessary to enable it to serve all persons included in the project for which the loan is made without payment by these persons of any extra charge as a contribution to the cost of construction of the facilities. As an extension policy, the borrower shall provide service to the widest extent practicable to other unserved persons desiring service after completion of the project without requiring payment by such persons of a contribution to the cost of constructing the facilities required to serve them. As a minimum requirement, the borrower will provide service without such contribution to at least those unserved persons who meet either of the following conditions:

(1) Service to such persons will not reduce the over-all density (the number

of subscribers per route mile of pole line underground cable and radio link) of the applicant's system below that which was contemplated in the loan as existing at the time of completion of the project.

(2) The cost of constructing the required line extension for such persons will not exceed seven times the estimated annual exchange revenue from such persons.

Service to persons in the above categories ("other unserved persons") not included in the project shall be pursuant to the terms and conditions set forth in the borrower's tariff as duly filed with or approved by the appropriate regulatory agency. However, the borrower is forbidden to file or submit for approval of a regulatory body, or adopt any proposed tariff, or continue in effect any existing tariff, "unless under such tariff the borrower shall be obligated to serve unserved persons as heretofore provided."

## *Recent Rate Developments*

THE $7,000,000 rate increase granted by the Michigan Public Service Commission to Michigan Bell Telephone Company was hailed as a great victory for Detroit area subscribers, but regarded as "far out of line with economic reality" by the company. The company had asked for $17,000,000 in rate boosts. Company officials said that more than half of the $7,221,882 increase would go to the Federal government in taxes and that the increase "falls seriously short of what is desperately needed to assure good telephone service in the future."

James H. Lee, assistant corporation counsel and Detroit's expert on utility rates, declared the rate increase an "admission of our contention that the Detroit area should be figured on a different rate base, because the solid concentration of subscribers makes for more efficient, less costly operation." The burden of the rate increase granted Michigan Bell will fall on outstate subscribers. The city of Detroit has long argued with the commission that Detroit users have been subsidizing the smaller communities and rural areas by paying the major share of previous rate increases. According to Lee, the city's intervention in Bell requests for rate increases over the past five years has saved Detroiters more than $35,000,000.

The commission approved a boost in pay phone tolls from a nickel to a dime, in addition to an increase of 75 cents a month on outside business telephones and a boost of 25 cents to 50 cents a month for residential subscribers in exchanges having less than 3,000 instruments.

THE Colorado commission has approved a 20 per cent increase in rates for the Mountain States Telephone & Telegraph Company. The commission gave its consent to a rate schedule drawn up by the company, calling for a $5,579,412 increase, despite strong protests from the city and county of Denver. The city contends that the new rates discriminate against large centers of population.

The commission explained that it had adopted the statewide principle of rate making sought by the company which is now in effect in thirty-one states and was recently upheld by New York's highest court. It declared the new rates to be "just, reasonable, nondiscriminatory, and nonpreferential."

In Denver, the new tariff means that business single-party phones on a flat rate are increased from $11.25 to $15.25 per month, and 2-party business phones from $9.25 to $11.75; 1-party flat rate resident phones from $4.15 to $5.45; 2-party flat rate residence from $3.65 to $4.60. The schedule proceeds on a descending scale of rates down to group I, where a 1-party business phone is increased from $4.25 to $5.75 and a 1-party residence phone from $2.65 to $3.45. Group I takes in exchanges with as few as 700 telephones.

THE Rhode Island Supreme Court has unanimously ruled invalid the $850,000 annual rate increase which the New England Telephone & Telegraph Company has been collecting from its subscribers since last August. Acting on

the protest of a Providence attorney, the supreme court said that Public Utility Administrator Thomas A. Kennelly erred in granting the company an increase in July, 1951.

The company had asked Kennelly to grant a temporary increase. After finding no emergency existing to justify it, Kennelly then granted an increase on other grounds. In doing this, the court said he in effect changed the petition into one for a permanent increase, but failed to give proper notice for a hearing on a permanent increase. At the same time, the court added, the company failed to file sufficiently comprehensive schedules and detailed information as a basis for such an increase.

The court said it recognized that the utility law should be liberally construed to accomplish its purpose and it appreciated Kennelly's position that in the public interest further expense would be saved if he should pass on the evidence before him and determine the question raised thereby. "However," the court remarked, "in our opinion the statute, though liberally construed, does not contemplate that a short cut be taken . . ."

### *Ohio PUC Enforces Antigambling Order*

THE public utilities commission of Ohio, in a precedent-setting action last month, ordered the removal of two telephones from a private home because of alleged gambling activities there. The commission's far-reaching order instructed the Ohio Bell Telephone Company to take out the phones immediately, in compliance with its antigambling order of December 21, 1951.

Five other similar cases have been heard by the commission and are before that agency for final determination. The city of Columbus was permitted to intervene in all six cases.

Last December the commission ordered all telephone and telegraph companies to remove their facilities upon complaint from local law officials who had reason to believe the facilities were being used in the furtherance of gambling activities. Last March, Ohio's safety director complained to the company against Edward Bell of Columbus and the alleged gambler's telephones were removed. Bell appealed to the commission, however, which ordered service restored pending a hearing. In its order of June 5th, calling for final removal of the phones, the commission found its instructions to restore service were contrary to the antigambling policy.

### *Indiana Bell Buys Up Independents*

THE Indiana Bell Telephone Company's bid for a part of the independent telephone properties owned by the late John T. Detchon was recently accepted by the Marion County Probate Court. Indiana Bell made its successful offer of $1,085,537 while a newly formed co-operative was negotiating with the Indiana National Bank for purchase of some of the properties. The new co-op, known as the Hoosier Telephone Cooperative, Inc., apparently intended to finance the purchase by borrowing the money from the Rural Electrification Administration.

In Washington, REA Administrator Wickard said he had been in Indiana looking over several companies, but stated emphatically that he was not a stockholder or shareholder in any organization getting money from the government. The acting manager of the new co-op is also general manager of the Indiana Statewide Rural Electric Cooperative, Inc.

It is expected that the co-op may purchase the remainder of the properties belonging to the Detchon estate, all of which are in the western part of the state and which are valued at $651,022. The properties on which Indiana Bell made its successful bid include twenty-three exchanges serving about 12,800 telephones. The purchase must still be approved by the Indiana Public Service Commission and the Federal Communications Commission.

# Financial News and Comment

By OWEN ELY

### *Methods of Equity Financing In 1951-52*

THE accompanying table (page 49) is designed to analyze the character of equity financing by electric and gas utilities in the calendar year 1951 and the first five months of 1952. Last year 69 per cent of common stock financing was through the medium of rights; this year in the first five months the percentage was only 54 per cent, but the huge Pacific Gas and Electric rights offering (about $68,000,000 offered to stockholders of record June 10th) should raise the percentage substantially. If telephone issues were included, the immense American Telephone rights offering of convertible debentures might be included as "delayed" equity financing.

The proportion of offerings for which the underwritings were negotiated was 48 per cent last year (total of rights and direct offerings), but this year the per cent increased to 72. (The pending Pacific Gas issue is also negotiated.) Thus the trend would seem to be toward negotiated common stock offerings, both in rights issues and direct offerings.

How successful has utility equity financing been? In the rights offerings the increasing use of oversubscriptions (subject to allotment) has lightened the selling job of underwriters. Last year only 19 out of 44 common stock offerings gave the oversubscription privilege. This year in the first five months 13 out of 24 did so. The oversubscription privilege almost always means a total subscription in excess of 100 per cent. Thus last year there was no case where total subscriptions were less than 100 per cent; in 1952 there have been only two cases, one of which was very small. With oversubscriptions there would seem to be less need for underwriting unless the issue is priced very close to the market; in the majority of cases the issues have been underwritten, probably as insurance against a bad market or some other emergency.

OFFERINGS to employees do not seem to produce important results, except of course in the case of American Telephone and Telegraph Company, which makes great concessions both on pricing and terms of payment. Where this device has been used by the electric and gas utilities the results have apparently not been an important factor in the success of the

DEPARTMENT INDEX

offering, and this year there have been fewer instances of such offerings.

There is no statistical measure of the success of direct offerings to the public, but the Irving Trust Company, in its monthly tabulations of new offerings, grades them a, b, c, d to indicate the relative success, "a" meaning well received, "b" fairly well received, "c" sold somewhat slowly, and "d" sold slowly. Last year, with a strong general stock market, direct offerings proved somewhat more successful than this year, as indicated by the amounts in millions under the different success ratings:

| *Rating* | *1951* | *1952 (5 months)* |
|---|---|---|
| a .......... | $109 | $67 |
| b .......... | 4 | 31 |
| c .......... | 19 | 12 |
| d .......... | 11 | — |
| Totals ....... | $143 | $110 |

There are of course other features which deserve study, such as compensation to dealers for soliciting subscriptions, company sharing in the profits of stock sold by underwriters, the average costs of underwriting and relative advantages of rights *versus* direct offerings, the effects of offerings on market prices, etc. Obviously, to cover all these would require a long and detailed study. Because of the variations in the individual issues it would be difficult to tabulate these factors so as to arrive at statistical averages; probably the best results would be obtained by studying the individual prospectuses and the monthly, quarterly, and annual compilations prepared by the Irving Trust Company, Ebasco Services, and the SEC.

## *Suggestions on Regular Interim Reports*

THE Irving Trust Company has consulted a number of utility analysts and summarized their views, as to the best means of keeping Wall Street advised through earnings statements, news letters, and other informal material circulated by the utility companies. The following conclusions were reached:

The analysts are in agreement on the importance of quarterly reports which include a statement of significant developments, an income statement, and a balance sheet. By far the majority want to receive comparative earnings figures on a three months' and twelve months' basis. As for the monthly reports, it is felt that it is sufficient if the income statements are furnished to the financial agencies for publication in their services, and here the prevailing opinion is that the 1-month and 12-month earnings periods on a comparative basis should be used.

As to earnings, the analysts would like to see the figures through the balance of income available for common stock. They would also like to have the earnings per share calculated on the number of shares outstanding at the end of the period as well as on the average number of shares, with the number of shares shown on which both figures are based.

A separate survey was made for electric light and power companies and for natural gas companies. However, the results were identical for both types of companies. It was felt that the quarterly interim reports should give, in addition to the income account and balance sheet, a statement of significant developments with respect to (1) territory, (2) rate changes, (3) future financing, (4) special facts (such as wage increases) affecting changes in earnings, etc.

THE table of electric utility earnings on pages 53, 54, and 55 indicates the character of the interim statements now issued by these companies, but does not show which reports include a discussion of recent developments. The latter is frequently very important for proper interpretation of the income statements. Analysts are particularly interested in the extent to which share earnings figures should be adjusted to reflect (on a *pro forma* basis) recently granted rate increases.

Such information, in our opinion, might well be placed in a footnote applying to the reported share earnings. Thus a hypothetical note might read as follows:

An increase in electric rates of $5,000,000 per annum was granted February 1st, equivalent to about $2,400,000 after income taxes. Only three months of this increase are reflected in the above figures for the twelve months ended May 31st, but on a *pro forma* basis, including a full year's increase, share earnings would be increased to ———. Some security prospectuses now contain a section called "Factors Affecting Earnings" which makes such adjustments, though not always on a per share basis.

REPORTING of earnings on *average shares* as distinct from *outstanding shares* seems to be increasing, since many companies apparently feel that a 1-for-5, or even a 1-for-10, common stock issue dilutes earnings to an unfair degree, despite the fact that such dilution is gradually offset by use of the "interest on construction credit." If the average share method is employed it would seem unfair to use the interest credit in addition, except for proceeds of senior financing. In any event, it would seem advisable to present share earings on both bases and let the reader take his choice. In connection with average shares, several different methods of averaging may be used —daily, monthly, or quarterly. Some public accountants are said to favor use of the quarterly method which ties in with dividend payments. This is the method followed by American Gas & Electric Company.

WE should be glad to have expressions of opinion from our readers as to whether an extra column should be included in the tables at the back of this department for earnings on an average share basis, where these figures are made available.

ANALYSIS OF UTILITY COMMON STOCK FINANCING

| | *1951* | | | *January–May, 1952* | | |
|---|---|---|---|---|---|---|
| | *Electric* | *Gas* | *Total* | *Electric* | *Gas* | *Total* |
| *Millions of Dollars* | | | | | | |
| *Rights Issues* | | | | | | |
| Negotiated | $136 | $ 9 | $145 | $ 67 | $12 | $ 79 |
| Competitive Bids | 45 | 21 | 66 | 29 | — | 29 |
| Not Underwritten | 68 | 35 | 103 | 17 | 3 | 20 |
| Totals | $249 | $ 65 | $314 | $113 | $15 | $128 |
| *Direct Offerings* | | | | | | |
| Negotiated | $ 33 | $ 40 | $ 73 | $ 63 | $29 | $ 92 |
| Competitive Bids | 67 | — | 67 | 18 | — | 18 |
| Total | $100 | $ 40 | $140 | $ 81 | $29 | $110 |
| Total All Issues | $349 | $105 | $454 | $194 | $44 | $238 |
| *Percentages* | | | | | | |
| *Rights Issues* | | | | | | |
| Negotiated | 39% | 9% | 32% | 34% | 27% | 33% |
| Competitive Bids | 13 | 20 | 14 | 15 | — | 12 |
| Not Underwritten | 19 | 33 | 23 | 9 | 7 | 9 |
| Total | 71% | 62% | 69% | 58% | 34% | 54% |
| *Direct Offerings* | | | | | | |
| Negotiated | 10% | 38% | 16% | 33% | 66% | 39% |
| Competitive Bids | 19 | — | 15 | 9 | — | 7 |
| Total | 29% | 38% | 31% | 42% | 66% | 46% |
| Total All Issues | 100% | 100% | 100% | 100% | 100% | 100% |

## *Interconnection of Electric Utilities*

THE extent to which the electric utilities have now been interconnected is indicated in the map on page 51, prepared by the Edison Electric Institute, and presented in the brochure "Electric Power in the United States and Overseas" by President Walker L. Cisler of Detroit Edison Company.

## *Utility Stocks Legal for Savings Banks in New York State*

THE state of New York now permits savings banks to invest a small part of their funds in preferred or common stocks, subject to certain standards as defined in the act (§ 26 of the Banking Law). Moody's service has issued a list of issues which it considered eligible, at the time of publication (April 26th), and this contains the utility common stocks shown in the table, page 52. Under the peculiar standards of the law, some well-known stocks such as Pacific Gas and Electric and Southern California Edison are omitted.

Some of the new holding company stocks such as Central & South West, Middle South Utilities, Southern Company, Texas Utilities, and New England Electric System are excluded, apparently because of the lack of a 10-year dividend record. Of the old-line holding companies, Philadelphia Company is included, but North American Company does not appear because for part of the 10-year period it paid only stock dividends. It seems rather amazing that a transit stock such as St. Louis Public Service (which does not earn its dividend) can qualify, while sound electric utility stocks like Niagara Mohawk Power and Long Island Lighting are barred.

It is unfortunate that the legislature set up the law apparently without adequate consultation with bankers, analysts, or representatives of the utilities themselves. The law would seem to be modeled somewhat after the old legal requirements for railroad issues, which are not at all adapted to the selection of sound utility stocks. In any event, some of the utilities now excluded will gradually find their way into the list as they are able to meet the "age" requirement. Meanwhile, the savings banks are unduly restricted in their choice of issues.

## *Advantages of Private Placements*

LEHMAN BROS. recently issued a pamphlet entitled "Private Placements —A Means of Raising Capital in a Changing Economy." The firm pointed out that prior to the 1930's practically all security issues were sold by public offerings, but that since then the method of private placement has become important as an alternative method. It means the direct sale of corporate securities to a limited number of investors (sometimes a single institution). Originally, such sales were made only to insurance companies, but in recent years other investment agencies such as pension funds have become important buyers. The functions of the investment banker in aiding such private placements are described as follows:

(a) The interpretation of economic and financial trends as they bear upon the issuer's capital requirements.

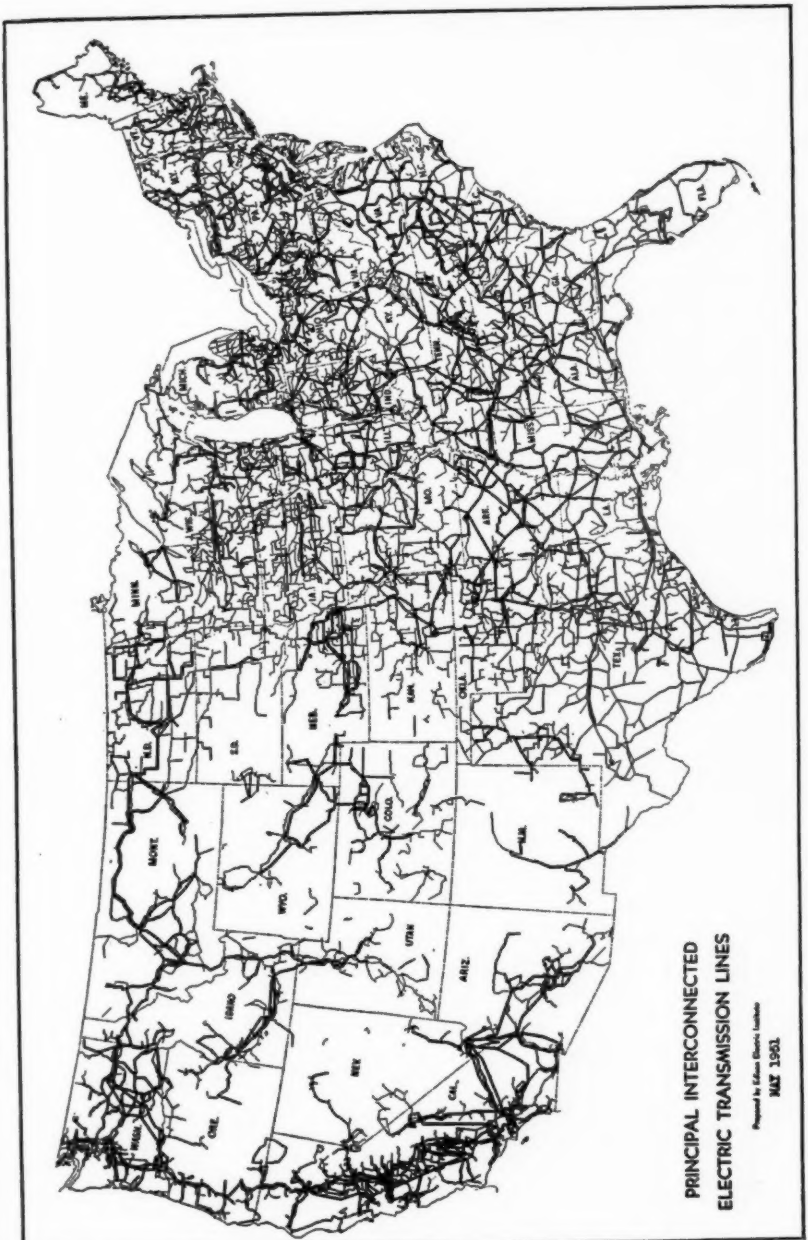
(b) Formulation of financing plans, suited to the issuer's particular needs and adapted to the current investment market.

(c) Preparation of descriptive and analytical data for submission to institutional investors.

(d) Negotiation with institutional investors of new issue provisions, which preserve for the issuer maximum flexibility, consistent with appropriate investment safeguards.

(e) Negotiation with institutional investors of dividend or interest rate, which equitably measures the quality of the new issue and the level of the prevailing money market.

(f) Collaboration with the legal staffs of the issuer and the institutional investor in concluding the transaction.


PRINCIPAL INTERCONNECTED
ELECTRIC TRANSMISSION LINES
Prepared by Edison Electric Institute
MAY 1952

Lehman Bros. over the past seventeen years placed 147 issues for 93 issuers. The aggregate amount was $1.3 billion, which included $150,000,000 for Radio Corporation of America (three transactions), $100,000,000 for Iron Ore Company of Canada, and many other important transactions.

REPRESENTATIVE Louis B. Heller, chairman of the House Interstate Commerce Subcommittee which has been investigating the SEC, apparently favors the registration of new securities sold directly to institutional investors. According to *Business Week*, he thinks the increasing trend toward private placements may be unfair to little investors. He is reported as stating that 59 per cent of all corporate bond issues were sold privately last year compared with only 21 per cent in 1945. It is not clear whether these figures refer to the number of issues or the aggregate dollar amount. In any event, the 1951 compilation for utility financing made by Ebasco Services (see FORTNIGHTLY of January 31st, page 173) indicated that only $618,000,000 utility issues were sold privately out of a total $2,944,000,000, or only about 21 per cent; in 1950 the proportion was 23 per cent.

SEC Chairman Cook apparently has not taken sides in the matter. It might be helpful for utility analysts to have available the prospectuses for privately placed issues, but this hardly seems nec-

PUBLIC UTILITY COMMON STOCKS

*Considered Legal for New York Savings Banks by Moody's Service*

*Electric-Gas*

American Gas & Electric
Atlantic City Electric
Boston Edison
Central Illinois Light
Cincinnati Gas & Electric
Cleveland Electric
Columbus & Southern Ohio Edison
Commonwealth Edison
Community Public Service
Consolidated Edison
Consolidated Gas of Baltimore
Consumers Power
Dayton Power & Light
Delaware Power & Light
Detroit Edison
Florida Power
Gulf States Utilities
Houston Lighting & Power
Idaho Power
Indianapolis Power & Light
Iowa-Illinois Gas & Electric
Iowa Power & Light
Kansas City Power & Light
Kansas Power & Light
Louisville Gas & Electric
Missouri Public Service
Montana Power
New York State Electric & Gas
Northern States Power
Ohio Edison
Oklahoma Gas & Electric
Pennsylvania Water & Power
Philadelphia Company
Philadelphia Electric
Potomac Electric Power
Public Service of Colorado
Scranton Electric
Toledo Edison
Virginia Electric & Power
Wisconsin Electric Power

*Gas*

Consolidated Natural Gas
Lone Star Gas
Mississippi River Fuel
Montana-Dakota Utilities
Northern Natural Gas
Oklahoma Natural Gas
Pacific Lighting
Pacific Public Service
Panhandle Eastern Pipe Line
Peoples Gas
Southern Natural Gas
United Gas Improvement
Washington Gas Light

*Telephone*

American Telephone & Telegraph
New England Telephone & Telegraph
Pacific Telephone & Telegraph
Peninsular Telephone

*Transit*

Capital Transit
National City Lines
St. Louis Public Service

*Water*

Hackensack Water

essary considering the wealth of information which is made available by utility companies in prospectuses, annual reports to stockholders, statistical reports to insurance companies, data books, interim statements, etc. The situation may be somewhat different for industrial companies which do not "live in a fish bowl" as do the utilities.

In any event, it is hard to see what the whole affair has to do with small investors. There would seem to be plenty of outlets for their investment activities, both in existing security markets and in new issues. The insurance companies are, on the whole, doing an excellent job. They purchase a large proportion of all security offerings in any event; whether they should buy in the open market, or through the medium of private placement, would seem to depend largely on the judgment of the borrowing company and its bankers. Some issues can better be placed privately, and there have been many cases where preferred stock issues have been badly handled in the competitive bidding markets, because this method makes it difficult to gauge correctly the institutional demand for an issue which may prove "sticky" in an unsettled market.

## *Issue to Aid Expansion*

COMMONWEALTH EDISON COMPANY has announced a 4-year construction program calling for the expenditure of about a half billion dollars. The company intends to obtain about $200,000,000 of this from cash resources, depreciation funds, and undistributed earnings. This will leave about $300,000,000 to be obtained through the sale of securities.

### FINANCIAL DATA ON ELECTRIC UTILITY STOCKS

| | | | | | | | Share Earnings* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1951 Rev. (Mill.) | | | 6/11/52 Price About | Div. Rate | Current Yield | Cur. Period | % Increase | Freq. Of Reports** | Price-Earns. Ratio | Div. Payout |
| $193 | S | American G. & E. ...... | 62 | $3.00# | 4.8% | $4.46a | — | my | 13.9 | 67% |
| 22 | O | Arizona Public Service .. | 14 | .80 | 5.7 | .95a | 23% | qy | 14.7 | 84 |
| 6 | O | Arkansas Mo. Power .... | 16½ | 1.00 | 6.1 | 1.23m | D13 | qy | 13.4 | 81 |
| 20 | S | Atlantic City Elec. ...... | 26 | 1.35 | 5.2 | 1.71a | 12 | my | 15.2 | 79 |
| 4 | O | Bangor Hydro Elec. ..... | 28 | 1.60 | 5.7 | 2.10m | D10 | qy | 13.3 | 76 |
| 2 | O | Beverly G. & E. ........ | 50 | 3.70 | 7.4 | 4.13d | 31 | a | 12.1 | 97 |
| 3 | O | Black Hills P. & L. .... | 20 | 1.28 | 6.4 | 1.70a | D5 | qy | 11.8 | 75 |
| 74 | B | Boston Edison .......... | 47 | 2.80 | 6.0 | 3.23m | 4 | qy | 14.6 | 87 |
| 13 | O | California Elec. Pr. .... | 9 | .60 | 6.7 | .66m | 8 | qy | 16.7 | 111 |
| 12 | O | Calif. Oregon Pr. ...... | 26 | 1.60 | 6.2 | 1.81a | D5 | b | 14.4 | 88 |
| 40 | S | Carolina P. & L. ........ | 37 | 2.00 | 5.4 | 2.79a | 4 | my | 13.3 | 72 |
| 18 | S | Cen. Hudson G. & E. .... | 11 | .60 | 5.5 | .79m | 22 | qy | 13.9 | 83 |
| 14 | O | Central Ill. E. & G. ...... | 24 | 1.30 | 5.4 | 2.18m | D1 | bq | 11.0 | 60 |
| 22 | S | Central Ill. Light ........ | 37 | 2.20 | 5.9 | 2.91a | 1 | mcy | 12.7 | 76 |
| 33 | O | Central Ill. P. S. ........ | 19 | 1.20 | 6.3 | 1.47m | D8 | qy | 12.9 | 82 |
| 8 | O | Central La. Elec. ....... | 34 | 2.00 | 5.9 | 2.76m | NC | qy | 12.3 | 72 |
| 24 | O | Central Maine Power .... | 18 | 1.20 | 6.7 | 1.45a | 7 | my | 12.4 | 83 |
| 80 | S | Central & S. W. ........ | 18 | .90 | 5.0 | 1.42m | 6 | qy | 12.7 | 63 |
| 8 | O | Central Vermont P. S. .. | 12 | .80 | 6.7 | 1.20a | 30 | my | 10.0 | 67 |
| 77 | S | Cincinnati G. & E. ...... | 39 | 2.00# | 5.1 | 2.92m | 5 | qy | 13.4 | 68 |
| 5 | O | Citizens Utilities ....... | 9 | .30# | 6.3 | .80m | 21 | qc | 11.3 | 38 |
| 80 | S | Cleveland Elec. Illum. .... | 53 | 2.60 | 4.9 | 3.82m | 7 | qy | 13.9 | 68 |
| 2 | O | Colorado Cent. Power ... | 17 | 1.00 | 5.9 | 1.37m | 4 | qc | 12.4 | 73 |
| 31 | S | Columbus & S. O. E. ..... | 23 | 1.40 | 6.1 | 2.04m | 9 | qy | 11.3 | 69 |
| 281 | S | Commonwealth Edison ... | 32 | 1.80 | 5.6 | 2.03m | D7 | qy | 15.8 | 89 |
| 7 | C | Community Pub. Ser. ... | 16 | .90 | 5.6 | 1.41m | 14 | qy | 11.3 | 64 |
| 1 | O | Concord Electric ....... | 35 | 2.40 | 6.9 | 2.52d | D5 | a | 13.9 | 95 |
| 48 | O | Connecticut L. & P. ..... | 15 | .88 | 5.9 | .97a | D4 | mcy | 15.5 | 91 |
| 16 | O | Connecticut Power ...... | 36 | 2.25 | 6.3 | 2.30m | D11 | qy | 15.7 | 98 |
| 418 | S | Consol. Edison .......... | 35 | 2.00 | 5.7 | 2.25m | 1 | qy | 15.6 | 89 |

| 1951 Rev. (Mill.) | | (Continued) | 6/11/52 Price About | Div. Rate | Cur-rent Yield | Share Earnings* Cur. Period | Share Earnings* % In-crease | Share Earnings* Freq. Of Re-ports** | Price-Earns. Ratio | Div. Pay-out |
|---|---|---|---|---|---|---|---|---|---|---|
| 84 | S | Consol. Gas Balt. ........ | 26 | 1.40 | 5.4 | 1.62m | D9 | qy | 16.0 | 86 |
| 129 | S | Consumers Power ...... | 36 | 2.00 | 5.6 | 2.69a | — | mcy | 13.4 | 74 |
| 49 | S | Dayton P. & L. ........ | 35 | 2.00 | 5.7 | 2.63m | 1 | qy | 13.3 | 76 |
| 23 | S | Delaware P. & L. ........ | 25 | 1.20 | 4.8 | 1.64m | D17 | qy | 15.2 | 73 |
| 6 | O | Derby G. & E. .......... | 21 | 1.40 | 6.7 | 1.45d | D30 | qc | 14.5 | 97 |
| 164 | S | Detroit Edison .......... | 24 | 1.40 | 5.8 | 1.64a | D5 | b | 14.6 | 85 |
| 89 | C | Duke Power ........... | 86 | 4.75 | 5.5 | 6.36m | D15 | bq | 13.5 | 75 |
| 7 | O | El Paso Electric ........ | 23 | 1.20 | 5.2 | 1.84a | 6 | my | 12.5 | 65 |
| 9 | S | Empire Dist. Elec. ...... | 22 | 1.40 | 6.4 | 2.16m | 10 | qy | 10.2 | 65 |
| 4 | O | Fitchburg G. & E. ...... | 46 | 3.00 | 6.5 | 3.12d | D15 | a | 14.7 | 96 |
| 25 | S | Florida Power Corp. .... | 20 | 1.20 | 6.0 | 1.46m | 1 | qy | 13.7 | 82 |
| 55 | S | Florida P. & L. ........ | 29 | 1.40 | 4.8 | 2.52m | 3 | qy | 11.5 | 56 |
| 137 | S | General Pub. Util. ...... | 24 | 1.40 | 5.8 | 1.90m | 16 | qy | 12.6 | 74 |
| 5 | O | Green Mt. Power ....... | 18 | 1.20 | 6.7 | 1.88f | 14 | qy | 9.6 | 64 |
| 33 | S | Gulf States Util. ........ | 24 | 1.20 | 5.0 | 1.55a | D1 | my | 15.5 | 77 |
| 18 | C | Hartford E. L. ........ | 48 | 2.75 | 5.7 | 2.76m | D6 | qy | 17.4 | 100 |
| 4 | O | Haverhill Electric ...... | 33 | 2.25 | 6.8 | 2.59d | D17 | qc | 12.7 | 93 |
| 41 | S | Houston L. & P. ........ | 22 | 1.00 | 4.6 | 1.52a | 17 | my | 14.5 | 66 |
| 17 | S | Idaho Power ........... | 36 | 1.80 | 5.0 | 3.12m | 22 | qy | 11.5 | 58 |
| 51 | S | Illinois Power .......... | 38 | 2.20 | 5.8 | 2.76a | D2 | b | 13.8 | 80 |
| 31 | S | Indianapolis P. & L. .... | 36 | 2.00 | 5.6 | 3.33m | 1 | qy | 10.8 | 60 |
| 15 | S | Interstate Power ........ | 9 | .60 | 6.7 | .86m | 8 | qy | 10.5 | 70 |
| 16 | O | Iowa Elec. L. & P. ...... | 15 | .90 | 6.0 | 1.45a | D9 | my | 10.3 | 62 |
| 24 | S | Iowa-Ill. G. & E. ........ | 26 | 1.80 | 6.9 | 2.14m | D12 | qy | 12.1 | 84 |
| 25 | S | Iowa Power & Light .... | 24 | 1.40 | 5.8 | 1.94m | 6 | bq | 12.4 | 72 |
| 22 | O | Iowa Pub. Service ...... | 21 | 1.20 | 5.7 | 1.78a | D5 | b | 11.8 | 67 |
| 9 | O | Iowa Southern Util. ..... | 17 | 1.20 | 7.1 | 1.20a | D12 | b | 14.2 | 100 |
| 36 | S | Kansas City P. & L. .... | 28 | 1.60 | 5.7 | 1.76a | D1 | b | 15.9 | 91 |
| 16 | O | Kansas Gas & Elec. ..... | 33 | 2.00 | 6.1 | 3.01a | D6 | my | 11.0 | 66 |
| 29 | S | Kansas Pr. & Lt. ....... | 18 | 1.12 | 6.2 | 1.32m | D8 | qy | 13.6 | 85 |
| 27 | O | Kentucky Utilities ...... | 16 | 1.00 | 6.3 | 1.47m | D2 | qy | 10.9 | 68 |
| 5 | O | Lake Superior D. P. .... | 27 | 1.80 | 6.7 | 2.73m | 11 | qy | 9.9 | 66 |
| 6 | O | Lawrence G. & E. ...... | 38 | 2.40 | 6.3 | 2.65d | D15 | qc | 14.3 | 91 |
| 53 | S | Long Island Lighting .... | 16 | .90 | 5.6 | 1.28m | 32 | qy | 12.5 | 70 |
| 35 | S | Louisville G. & E. ...... | 37 | 1.80 | 4.9 | 3.15m | 14 | qy | 11.7 | 57 |
| 6 | O | Lowell Elec. Lt. ........ | 45 | 3.00 | 6.7 | 3.70d | D7 | qc | 12.2 | 91 |
| 8 | O | Lynn G. & E. .......... | 27 | 1.60 | 5.9 | 1.56d | D26 | a | 17.3 | 103 |
| 6 | O | Madison G. & E. ........ | 32 | 1.60 | 5.0 | 2.47d | 7 | q | 13.0 | 65 |
| 3 | C | Maine Public Service ... | 17 | 1.20 | 7.1 | 1.51m | 9 | my | 11.3 | 79 |
| 3 | O | Michigan G. & E. ...... | 29 | 1.80 | 6.2 | 2.67m | 9 | qy | 10.9 | 67 |
| 112 | S | Middle South Util. ...... | 24 | 1.30 | 5.4 | 1.72a | 10 | qy | 14.0 | 76 |
| 17 | S | Minnesota P. & L. ...... | 35 | 2.20 | 6.3 | 3.15a | D8 | my | 11.1 | 70 |
| 1 | O | Missouri Edison ........ | 10 | .70 | 7.0 | 1.14m | D4 | qy | 8.8 | 61 |
| 6 | C | Missouri P. S. .......... | 17 | .90 | 5.3 | 1.56m | — | qc | 10.9 | 58 |
| 5 | O | Missouri Utilities ....... | 16 | 1.00 | 6.3 | 1.62d | 13 | qy | 9.9 | 62 |
| 27 | S | Montana Power ........ | 27 | 1.55 | 5.7 | 2.43a | D2 | my | 11.1 | 64 |
| 13 | C | Mountain States Pr. .... | 13 | .84 | 6.5 | 1.22m | 3 | qy | 10.7 | 69 |
| 105 | S | New England Elec. ...... | 13 | .90 | 6.9 | 1.33m | D1 | qc | 9.8 | 68 |
| 34 | O | New England G. & E. ... | 15 | 1.00 | 6.7 | 1.24a | D7 | b | 12.1 | 81 |
| 38 | O | New Orleans P. S. ...... | 40 | 2.25 | 5.6 | 2.61a | D8 | my | 15.3 | 86 |
| 2 | O | Newport Electric ........ | 29 | 2.00 | 6.9 | 2.32a | D18 | my | 12.5 | 86 |
| 57 | S | N. Y. State E. & G. .... | 33 | 1.70 | 5.2 | 2.49a | 25 | my | 13.3 | 68 |
| 176 | S | Niagara Mohawk ........ | 27 | 1.60 | 5.9 | 1.93m | 24 | qy | 14.0 | 83 |
| 89 | S | North American ........ | 22 | 1.20 | 5.5 | 1.33m | D8 | qy | 16.5 | 90 |
| 51 | O | Northern Ind. P. S. ..... | 25 | 1.52 | 6.1 | 2.23a | D1 | c | 11.2 | 68 |
| 89 | S | Northern States Pr. ..... | 11 | .70 | 5.8 | .91m | — | qy | 12.1 | 77 |
| 8 | O | Northwestern P. S. ...... | 12 | .80 | 6.7 | 1.28m | — | qy | 9.4 | 63 |
| 96 | S | Ohio Edison ........... | 34 | 2.00 | 5.9 | 2.71a | — | mcy | 12.5 | 74 |
| 29 | S | Oklahoma G. & E. ...... | 24 | 1.40 | 5.8 | 1.78m | 19 | qy | 13.5 | 79x |
| 13 | O | Otter Tail Power ...... | 22 | 1.50 | 6.8 | 1.70a | D21 | c | 12.9 | 88 |
| 279 | S | Pacific G. & E. .......... | 33 | 2.00 | 6.1 | 2.31a | NC | bq | 14.3 | 87 |
| 20 | O | Pacific P. & L. .......... | 18 | 1.10 | 6.1 | 1.54m | 22 | my | 11.7 | 71 |
| 85 | S | Penn Power & Light .... | 29 | 1.60 | 5.5 | 2.38a | 16 | my | 11.7 | 67 |

| 1951 Rev. (Mill.) | | (Continued) | 6/11/52 Price About | Div. Rate | Current Yield | Share Earnings* — Cur. Period | % Increase | Freq. Of Reports** | Price-Earns. Ratio | Div. Payout |
|---|---|---|---|---|---|---|---|---|---|---|
| 7 | C | Penn Water & Power .... | 38 | 2.00 | 5.3 | 2.24d | — | qc | 17.0 | 89 |
| 165 | S | Philadelphia Electric .... | 30 | 1.50 | 5.0 | 2.09m | D8 | qy | 14.4 | 72 |
| 25 | O | Portland Gen. Elec. ....... | 28 | 1.80 | 6.4 | 2.38a | 4 | c | 11.8 | 76 |
| 43 | S | Potomac Elec. Power .... | 16 | .90 | 5.6 | 1.24m | 31 | qy | 12.9 | 73 |
| 49 | S | Pub. Serv. of Colo. ..... | 30 | 1.40 | 4.7 | 2.15m | 1 | qy | 14.0 | 65 |
| 201 | S | Pub. Serv. E. & G. ...... | 26 | 1.60 | 6.2 | 2.11m | NC | qc | 12.3 | 76 |
| 50 | S | Pub. Serv. of Ind. ...... | 30 | 1.80 | 6.0 | 2.29a | 13 | c | 13.1 | 79 |
| 17 | O | Public Serv. of N. H. .... | 26 | 1.80 | 6.9 | 1.79a | 23 | mcy | 14.5 | 101 |
| 7 | O | Public Serv. of N. M. .... | 9 | .56 | 6.2 | .84d | 5 | qy | 10.7 | 67 |
| 21 | O | Puget Sound P. & L. .... | 19 | .80 | 4.2 | 1.59m | D15 | my | 11.9 | 60 |
| 38 | S | Rochester G. & E. ...... | 36 | 2.24 | 6.2 | 2.45m | — | qy | 14.7 | 91 |
| 8 | O | Rockland L. & P. ........ | 11 | .60 | 5.5 | .68d | D3 | b | 16.2 | 88 |
| 29 | O | San Diego G. & E. ..... | 14 | .80 | 5.7 | 1.32a | 15 | b | 10.6 | 61 |
| 11 | S | Scranton Elec. .......... | 14 | 1.00 | 7.1 | 1.03a | D13 | my | 13.6 | 97 |
| 5 | O | Sierra Pacific Power .... | 25 | 1.60 | 6.4 | 1.93a | D3 | my | 13.0 | 83 |
| 118 | S | So. Calif. Edison ........ | 35 | 2.00 | 5.7 | 3.03m | 11 | qy | 11.6 | 66 |
| 23 | S | So. Carolina E. & G. ..... | 10 | .60 | 6.0 | .63m | — | mcy | 15.9 | 95 |
| 4 | O | Southern Colo. Pr. ...... | 11 | .70 | 6.4 | .89f | 10 | c | 12.3 | 79 |
| 154 | S | Southern Company ...... | 14 | .80 | 5.7 | 1.17a | 21 | my | 12.0 | 68 |
| 11 | S | So. Indiana G. & E. ...... | 23 | 1.50 | 6.5 | 1.94a | D12 | mcy | 11.9 | 77 |
| 2 | O | Southwestern E. S. ..... | 14 | .88 | 6.3 | 1.41f | 8 | — | 9.9 | 63 |
| 23 | O | Southwestern P. S. ..... | 19 | 1.12 | 5.9 | 1.37a | 17 | mcy | 13.9 | 82 |
| 6 | S | St. Joseph L. & P. ...... | 26 | 1.60 | 6.2 | 2.11m | 5 | qy | 12.3 | 76 |
| 13 | C | Tampa Electric ......... | 39 | 2.40 | 6.2 | 3.06a | D7 | my | 12.7 | 78 |
| 82 | S | Texas Utilities .......... | 38 | 1.68 | 4.4 | 2.76a | 29 | qy | 13.8 | 61 |
| 31 | S | Toledo Edison .......... | 11 | .70 | 6.4 | .96m | 1 | qy | 11.5 | 73 |
| 7 | O | Tucson G. E. L. & P. .... | 27 | 1.60 | 5.9 | 2.55m | 18 | bq | 10.6 | 63 |
| 23 | O | United Illum. .......... | 41 | 2.40 | 5.9 | 2.38d | D16 | — | 17.2 | 100 |
| 2 | O | Upper Peninsula Pr. ...... | 16 | 1.20 | 7.5 | 1.44m | 5 | bq | 11.1 | 83 |
| 24 | S | Utah Power & Light ..... | 31 | 1.80 | 5.8 | 2.37a | D5 | mcy | 13.1 | 76 |
| 69 | S | Virginia E. & P. ........ | 23 | 1.40 | 6.1 | 1.77a | 5 | mcy | 13.0 | 79 |
| — | O | Washington Water Power | 26WD | 1.30 | 5.0 | 1.52a | 22 | my | 17.1 | 86 |
| 100 | S | West Penn Elec. ........ | 32 | 2.00 | 6.3 | 2.90a | 3 | c | 11.0 | 69 |
| 54 | O | West Penn Power ...... | 39 | 1.85 | 4.7 | 2.32m | D4 | qy | 16.8 | 80 |
| 8 | O | Western Lt. & Tel. ...... | 25 | 1.60 | 6.4 | 2.18m | 8 | qy | 11.5 | 73 |
| 19 | O | Western Mass. Cos. ..... | 31 | 2.00 | 6.5 | 2.10d | D22 | qc | 14.8 | 95 |
| 73 | S | Wisconsin E. P. ........ | 24 | 1.30 | 5.4 | 2.04m | D9 | qy | 11.8 | 64 |
| 26 | O | Wisconsin P. & L. ...... | 19 | 1.12 | 5.9 | 1.66m | 16 | qy | 11.4 | 67 |
| | | Averages .................... | | | 5.9% | | | | 13.0 | 77% |
| *Canadian Companies††* | | | | | | | | | | |
| 134 | C | Brazilian Trac. L. & P. .. | 10 | $1.00 | 10.0% | $2.47d | 5 | qc | 4.0 | 40 |
| 15 | C | Gatineau Power ......... | 18 | 1.20 | 6.7 | 1.30d | D11 | qc | 13.8 | 92 |
| 8 | C | Quebec Power .......... | 18 | 1.00 | 5.6 | 1.17d | D11 | qc | 15.4 | 86 |
| 37 | C | Shawinigan Water & Pr. . | 43 | 1.45 | 3.4 | 1.84d | D7 | qc | 23.4 | 79 |
| 16 | C | Winnipeg Elec. .......... | 36 | 2.40 | 6.7 | 2.26d | D7 | a | 15.9 | 106 |

a—April, 1952. d—December, 1951. f—February, 1952. m—March, 1952. B—Boston exchange. C—Curb exchange. O—Over-counter or out-of-town exchange. S—New York Stock Exchange. D—Decrease. E—Estimated. NC—No comparable figures available. PF—*Pro forma*. WD—When delivered. *If additional common shares have recently been offered, earnings are adjusted to give effect to the offering. Percentage change is in the balance available for common stock. ††While these stocks are listed on the Curb, Canadian prices are used. (Curb prices are affected by exchange rates, etc.) #Stock dividend also paid in 1951. **The following symbols are used in this column to indicate the periods and frequency of earnings reports: a—Calendar year only. b—Twelve months only (reported monthly). bq—Twelve months only (reported quarterly). c—Cumulative months and twelve months. m—Month only. mc—Latest month and cumulative months. mcy—Latest month, cumulative months, and twelve months. mqy—Latest month, three months, and twelve months. my—Latest month and latest twelve months. q—Latest quarter only. qc—Quarters cumulatively. qy—Latest quarter plus last twelve months. x—The dividend pay-out ratio would be 74 per cent on the basis of budgeted earnings of $1.90 for the calendar year 1952.

# What Others Think

## Do Regulatory Concepts Need Adjustment for Inflation?

A NUMBER of scholars, as well as practitioners, of utility regulation are beginning to wonder whether the accepted "utility formula" for rate fixing may not need some overhauling, here and there, in the light of changing economic conditions. FPC Commissioner Nelson Lee Smith, for example, in his interesting concurring opinion in the recent Northern Natural Gas Case, seems to be the latest authority who is feeling uneasy over the practical application of strict adherence to the original cost less depreciation formula for fixing utility rates under any and all circumstances.

The current (May) issue of *Land Economics,* the quarterly journal of planning, housing, and public utilities, issued by the University of Wisconsin, contains a 40-page article by Professor Walter A. Morton of the department of economics of the University of Wisconsin, dealing with the practical possibilities of a more realistic approach to regulation, in the light of present-day inflationary conditions. Professor Morton's article, entitled "Rate of Return and the Value of Money in Public Utilities," is summed up quite neatly in the following prefatory paragraph:

> Regulatory bodies are now being asked to allow higher earnings for utilities to compensate for inflation. Should commissions grant this request, or should they ignore price changes and base valuation procedures on nominal cost under the historical cost doctrine? It is held below that the power to regulate should not and does not convey the right to enforce purely nominal valuations on public utilities which, in the event of inflation, tend to destroy the real value of utility property. It is shown, however, that the use of reproduction cost is an undesirable method of attempting to allow for monetary depreciation, that the nominal historical cost doctrine though expedient during periods of stability is inherently fallacious when the value of money changes, and that the policy of adjusting the rate of return to the cost of money does not and cannot compensate for inflation. In order to prevent gradual expropriation of utility property in the event of inflation, the rate of return should contain an inflation adjustment which is applied only to the common stock equity. Such an adjustment is not necessary to attract new capital but it is fair and equitable. Under present circumstances, it seems that the stockholders of the average electric utility in the United States would be compensated for inflation by an addition of about .7 per cent to the present rate of return. A formula is suggested for computing the price adjustment which might enable regulatory commissions to make a reasonable compromise between extreme positions, provide a workable method of adjustment for inflation, and do justice both to consumers and holders of utility equity securities.

MUCH of Professor Morton's article deals with the background of public utility regulation which led to the necessary monopolistic concept and its regulatory obligations. Morton makes a strong point of equity, however, when he states his own conviction that the historical cost or "nominal dollar doctrine" of utility regulation, however convenient and workable, was never "intended to provide a technique for expro-

priating the investor." He then states:

> . . . No inexorable logic compels one to accept the view that because the plant is carried at original cost the utility should be permitted to earn only on this cost during a period of inflation or deflation. This is a matter of public policy, not of accounting, nor of logic.

Under the subhead "Fallacy of Nominal Dollar Doctrine," Professor Morton gets down to cases. After citing concrete examples of what happens to the investor during deflation and inflation, the nominal dollar formula is denounced as unfair because it is a one-way street. Professor Morton says on this:

> The original investor was robbed during the inflation and now has been restored to his original position by deflation, but the investor of inflated dollars gets a great windfall through deflation. Of course the consumer would not tolerate such high payments for utility services and would soon put an end to the nominal dollar theory. This theory of valuation would therefore be applicable only so long as it expropriated the investor; it would not be applied when it put a great burden on the consumer. No matter how intended, in hard cases it becomes a one-way theory.

On the "cost of money," which is currently being given quite a play among the regulatory commissions in holding down rate increases, Professor Morton concludes, by a process of elimination, that cost of money bears no relationship to price level. It may remain stable or fall while prices rise or fall. Consequently, the money market does not compensate automatically for inflation and, if that is desired, the combination must be provided by a procedure which breaks completely with the theory that "cost of money" and "fair rate of return" are practically equivalent.

As the Wisconsin professor puts it, regulation must "openly recognize that a fair rate of return consists of two factors: (1) cost of money, (2) plus or minus combination for inflation and deflation. Professor Morton places his case for inflation adjustment squarely on the foundation of equity. He dismisses as a false premise reasons of "economic necessity." He says "the effects of direct confiscation must not be confused with indirect confiscation by means of inflation."

He believes that the stockholder not only should be protected by an inflation adjustment, but utilities should be permitted to issue bonds and preferred stocks with a purchasing power clause provided that bond buyers are willing to risk money payments fluctuating up and down with prices. During periods of rising prices the cost of servicing the debt would rise and rates would have to be raised accordingly. If prices fell, debt service would fall and rates could be reduced.

Morton doubts that institutional investors with fixed-money liabilities would be interested in such a security, but that no legal or regulatory obstacle should be placed in its way. Professor Morton's price adjustment formula is given in mathematical terms and worked out in concrete examples. The inflation adjustment proposed is about .7 per cent so that the net upward adjustment in the rate of return would be .2 per cent. However, if inflation continues to rise, the price adjustment would rise. A doubling of prices from present levels would raise the inflation adjustment from .7 per cent to about 3 per cent, which would offset any likely fall in the cost of money due to assurance of inflation protection.

It is conceded that any considerable inflation would cost the consumer more than he would be paying under the nominal cost rule. He conceded also that in some cases companies and commissions may consider inflation adjustment presently inapplicable. But Morton thinks the principle of adjustment remains sound and may come to have more relevance to the future in order to maintain the real value of utility investment.

—F. X. W.

# A Study of Advertising for Factories

WHEN a utility company, or its town, advertises for factories, it may be long after that they come. So results are hard to pin down.

Yet this advertising goes right on, and researchers at the University of Santa Clara have been probing into results, and have published a report that has interest for chambers of commerce, utility companies, railroads, newspapers, banks, engineering firms, and government development agencies that do this advertising.

What publications are most used; which bring the most replies?

What does the community offer as an inducement to move a factory?

Does advertising make the community more widely known; identify the advertising organization as a source of information; give evidence that the community has an industrial development program?

In this order these publications are most widely used: *Business Week, Fortune, The Wall Street Journal, U. S. News,* metropolitan dailies, *Newsweek,* trade journals, *Time, Dun's Review,* general magazines, *Nation's Business, Forbes, Harvard Business Review,* and *Barron's.*

But media bringing the most replies run thus: metropolitan dailies, *Business Week, Newsweek, Fortune, The Wall Street Journal,* trade journals, *Nation's Business, Dun's Review,* general magazines, and *Time.*

Advertising is beamed at the areas where the factories are: New England, Middle Atlantic states; New England seeks factories from New York and New Jersey; the South seeks them in New England.

THE major four inducements offered are: (1) labor supply, (2) access to markets, (3) transportation facilities, and (4) raw materials. Secondary or specialized considerations are: cheap power or fuel, abundant water, suitable factory sites with room to grow, pleasant living conditions and climate. A recent inducement is location inland with security from bombing. Low taxes are at the very foot of the list—probably an advantage not deliverable!

The basic reasons given for advertising indicate that the community has been studied, and lacks something. It has grown fast, and needs more payrolls; is a single industry town, needs diversification; or it is agricultural, needs factories; has lost factories, wants others; has lost population or is standing still; is worried by the industrial expansion of neighbors, wants to grow, too.

The number of replies received varies from 1,533 that came in during ten months to a group of utility companies, down to 350 in a year. Advertisers generally feel that the number of replies is not important as an indication of results—some consider the number confidential.

There is little dissatisfaction with results. Most organizations report that advertising appropriations will be increased, or kept at present levels. Dissatisfaction is charged to lack of definite objectives in copy or campaign; too limited a campaign; lack of proper follow-up; poor choice of media and copy.

This advertising is regarded as only part of a comprehensive program, which should include printed matter for follow-up, personal calls on interested factory owners by citizens or organization officials, full information to community leaders, legislators, and others about what is being done to stabilize the community, and even community "days" or "weeks" to remind citizens that the community has something to sell, and is conducting a campaign to sell it.

—J. H. C.

BIDDING FOR INDUSTRIAL PAYROLLS, Bureau of Research, University of Santa Clara, Santa Clara, California. Price $2.25.

# The March of Events

## In General

### Court Sets Hearing

THE U. S. District Court at Portland, Maine, will hold a hearing on July 17th on the distribution plan of American Power & Light Company by which it plans to get rid of its $50,000,000 stock interest in Washington Water Power Company.

The hearing date was announced by the Securities and Exchange Commission. SEC already had approved the plan and had asked the court to order its enforcement.

American Power owns all the Washington Water Power stock. American Power, a public utility holding company, is under an SEC order to liquidate. The Washington Water Power stock is one of its last major holdings.

The stock of the Spokane utility would be distributed to American Power & Light shareholders on a 1-for-1 basis.

### Broader Power Program Needed

REPRESENTATIVE Michael J. Kirwan (Democrat, Ohio) told President Truman last month that in view of the heavy expansion of the television industry, the country needed a broader public power program to put electricity into more homes.

Kirwan told reporters he saw a news story recently that there would be 47,000,000 television receivers in this country within ten years. He then asked for a conference with Mr. Truman to urge that the Democrats include a strong public power plan in their 1952 platform.

He said Mr. Truman agreed with him fully on the continuing need for strong public power representation by the Democrats.

## District of Columbia

### Bus Fare Hike Blocked

THE District of Columbia Public Utilities Commission last month denied Capital Transit's request for an immediate fare increase. The company had asked the commission to boost fares on June 29th by abolishing tokens and weekly passes, thus making the present 15-cent cash fare apply to all riders.

To prevent the requested fares from taking effect until it has held a hearing, the commission ordered that present fares be continued until a hearing. No hearing date was set at that time.

Just before filing for the increase, Capital Transit had asked Congress for legislation to permit temporary fare increases without a hearing. The request appeared to have no chance of action in this session.

## Illinois

### Pay Increase Approved

THE regional Wage Stabilization Board recently approved a general pay increase of 15.6 cents an hour for 12,864 members of the AFL International Brotherhood of Electrical Workers employed by the Commonwealth Edison

Company and the Public Service Company of Northern Illinois.

The board unanimously approved an increase of 10 cents an hour for second and third shift workers; rate range adjustments, and a bonus plan for meter readers; and an additional increase to individual employees. However, industry members of the board contended that a 14-cent general raise was the most that could be allowed under regulations.

Hoyt P. Steele, vice president of Benjamin Electric Company, Des Plaines, signed a dissenting opinion for industry members, charging that public members disregarded a request to call in union and company representatives to find out whether the additional 1.6 cents was to adjust intraplant inequities. A majority opinion asserted that the union and company representatives had conferred with the regional chairman of the board and had said the additional 1.6 cents was to adjust inequities.

# Maine

## Water Subject to Sales Tax

An opinion handed down by the Maine Law Court on June 9th held that water delivered to users by municipalities or water districts is clearly subject to the state's 2 per cent sales tax.

Although only 12 cents was involved in the case before the court, the opinion pointed out that "the principle involved . . . is important if the contentions of the petitioners were valid."

The case was brought against the state tax assessor by the inhabitants of the city of Lewiston.

# Massachusetts

## Court Upholds Increased Rates

The state supreme judicial court recently upheld increased rates charged consumers by the Boston Consolidated Gas Company. The decision was said to mean that gas consumers would continue to pay between $400,000 and $500,000 more than under rates set by the state department of public utilities.

The rate case went to the supreme judicial court when Judge Williams of the supreme court voided the rate schedule set up by the department.

Since his decision the increased rates have been in effect under a $700,000 bond posted by the company. The bond was used to assure reimbursement of consumers.

## Senate Kills Bill

A bill advocated by Governor Dever to expand and strengthen the Massachusetts State Commission on the Necessaries of Life and create the position of consumers' counsel was killed by the state senate last month. Similar proposals have been rejected by the state legislature for the last three years.

Under the measure, the commission would have been given broad powers to investigate private businesses under the guise of preventing excessive prices for essential commodities and services. The consumers' counsel would have been empowered to represent the public at hearings and oppose price and rate increases.

# Missouri

## Attitude Shifts on Basin Control

Representatives of important business interests of the Kansas City area appeared before the Missouri Basin Survey Commission last month, prepared to speak in favor of some form of cen-

tralized regional management for development of water and land resources of the basin.

This was said to be a notable departure from the past attitude, which favored the existing method of operation under independent Federal agencies, subject to voluntary, extralegal co-ordination by the Missouri Basin Interagency Committee.

The hearing in Kansas City was the commission's first in Missouri, in its basin-wide inquiry into development plans and its assigned task of seeking a better form of management. Hearings were scheduled for Jefferson City, Hermann, and St. Charles.

# New York

## No-strike Legislation Proposed

ASSEMBLYMAN Elisha T. Barrett recently proposed legislation aimed at avoiding "unreasonable inconvenience" in public transportation strikes. His proposal was prompted by the Long Island Railroad walkout.

The Suffolk county Republican said he would sponsor a bill in the 1953 legislature providing that no strike involving public transportation could take effect until forty-eight hours after the public had been notified through regular news channels. Barrett said his proposal "can in no way be interpreted as an antistrike or antilabor bill."

"Its purpose would be to give some notice to avoid unreasonable inconvenience to the public who depend on rail transportation from Long Island communities to get to their work," he said.

# Ohio

## Increase in Rural Area Rates Authorized

THE state public utilities commission recently authorized the Ohio Edison Company to increase its electric rates by $860,000 a year in 34 rural counties.

The company consolidated 157 old rate schedules into four new schedules to equalize electric rates in its rural territory. In its application Ohio Edison said the old rates were inequitable because they had been established by a number of other power companies taken over by Ohio Edison. One of these, the Ohio Public Service Company, formerly served a large part of the 34-county rural area affected.

A commission spokesman said rates of the 5-county Springfield system were increased $31,308 a year, and those in the 29-county central system were increased by $832,770 a year.

# Washington

## Court Will Hear Dam Appeal

THE state supreme court has agreed to accept the Box Canyon dam appeal. In a report from Olympia early last month, the Associated Press said the high court would review the case in which a superior court judge held that Pend Oreille County Public Utility District No. 1 had insufficient authority to build the dam.

Judge Ott of Ritzville, after a series of hearings in Ritzville, Newport, and Spokane, ruled the district alone could not build such a project unless 51 per cent of the power to be generated would be sold within the district "within a reasonable time." He concluded most of the power would have to be sold outside the district.

Judge Ott held the district had not acted arbitrarily in attempting construction of the dam and that the plan for financing construction was acceptable.

# Progress of Regulation

## Tax Accruals Deducted from Working Capital Allowance and Allocation Methods Prescribed

THE Federal Power Commission, in disapproving a new natural gas pipeline company's proposed rates, reduced the amount claimed by the company as an allowance for working capital. The allowance was required to be reduced by the amount of cash available by reason of the collection of Federal taxes in advance of payment.

The commission observed that a cash working capital allowance is designed to provide sufficient cash funds from which the company can meet its operating costs in advance of their recoupment from the customers. It believed that if the gap between necessary expenditures and the collection of revenues is narrowed by reason of the collection of Federal income taxes from consumers far in advance of disbursement, it is only fair and equitable that the consumer be given appropriate credit for his advance payments.

The company had claimed a cash allowance of one-eighth, or forty-five days, of the total annual expenses which require working capital. It urged that the commission's adjustment represented a departure from the long-established method of determining working capital. Furthermore, the company claimed that it was being deprived of a return upon a portion of its investment.

The commission pointed out that present methods of paying corporate Federal income taxes provide a utility with large amounts of cash working capital. Each month's revenue collected by a utility includes a certain amount of Federal income taxes, since the rates are designed to include a proportional amount of income taxes to be paid from such revenue. The collection of these taxes from the consumer is made months in advance of the time the tax is paid.

Consequently, the commission believed that the consumer has provided the utility with relatively large amounts of cash working capital which are available for corporate purposes. It concluded that so long as the consumers bear the burden of Federal income taxes through rates, the utility should not realize a return from these working capital funds thus furnished by the ratepayers.

Observing that this element of working capital is analogous to capital contributed by the consumer in the form of contributions in aid of construction, the commission pointed out that it has consistently required that such contributions be deducted from the rate base on the ground that the ratepayer should not be required to pay a return on capital provided by him.

The company claimed that it was not using and should not use its tax accruals in financing its operations. It showed that a temporary investment was in Treasury Savings Notes in the approximate amount of its annual Federal income tax accruals. The law provides annual interest rates on such notes of from 1.44 per cent to 1.88 per cent. It was admitted that management is free to invest in securities any of its funds received

through rates or otherwise. Earnings on such investments inure solely to the owners of the business. Management policy as to investment of funds currently collected through rates for the purpose of meeting expenses, cannot, however, be recognized as determinative of the reasonableness of the allowance for cash working capital.

The company's costs of service were allocated between jurisdictional and nonjurisdictional sales according to the volumetric method of allocation. In such an allocation all costs of doing business are assigned proportionately to every thousand cubic feet of natural gas delivered from the system. Equal weight is given to the demands and use of the system on each of the days of the test period. No special weight is given to peak-period deliveries. This method of allocation was considered proper since this was a new company and the system capacity did not limit peak deliveries at all.

Customers' demands were growing from day to day. The commission did not deem it appropriate to allocate any of the costs on a peak-period demand basis because of the relative insignificance of the peak load on the company's system at this time. It believed that because the company's loads were in the stage of development, and there was a large amount of unused capacity on the system, the peak-day deliveries did not afford a reasonable basis for allocating demand costs.

Although the commission used a 6 per cent rate of return for this proceeding, it observed that such a rate for a new company during its development period is quite liberal. It said that such a return is usually commanded only by companies which have passed out of their development period. *Re Alabama-Tennessee Nat. Gas Co. Docket No. G-585, Opinion No. 226, May 1, 1952.*

## Transportation of Train Crews Not Required

In order to require a railroad to furnish daily transportation for train crews between crew-board offices and outlying facilities, held the Illinois Supreme Court, such transportation must be necessary and there must be an outlying terminal.

In this instance, the court held, the outlying facilities did not constitute a terminal. The commission had held that the crew-board offices, which were near the downtown depot, and the outlying roundhouse and yard office were an outlying terminal. The court pointed out that the whole terminal must be located beyond the city, and not partly within and partly without the city, and that the evidence did not establish that there was an outlying terminal beyond the city, or any separate terminal distinct from that partly located in the downtown business area.

The court further held that public necessity for such transportation was not established upon substantial evidence that a number of employees would be convenienced by such transportation but a substantial number would be inconvenienced. *Illinois C. R. Co. v. Illinois Commerce Commission, 104 NE2d 796.*

## Natural Gas Fixed Costs Allocated Equally to Demand and Commodity Components

The Federal Power Commission modified a presiding examiner's order disapproving wholesale natural gas rates and prescribing new ones, although it did deny certain exceptions to his decision. The examiner had prescribed rates which would produce a 6 per cent return for 1952. The companies claimed this was inadequate because it would not permit them to earn an average return of 6 per cent for the 3-year period during which the new rates were being investigated. They claimed that they were entitled to a return of over 7

per cent for the year 1952 to yield such an average return.

The commission, rejecting this argument, said that there is no statutory or constitutional provision entitling the companies as of right to such assured average earnings, or justifying rates which would produce a return of over 7 per cent in 1952. It held that a company may not insist, as a matter of constitutional right, that past losses may be made up by rates to be applied in the present and future.

Section 5(a) of the Natural Gas Act gives the Federal Power Commission authority to fix rates for the future. Under the act the commission may not prescribe rates for the future which will recompense a company for past deficiencies in earnings. Nor may it penalize a company by prescribing rates for the future designed to offset excessive earnings in the past.

The examiner was held to have erred in allocating certain operating expenses wholly to the demand component of the cost of service. He did this with respect to supplies and expenses for the measuring and pumping station, labor, operation of transmission mains, maintenance expense, and all taxes other than income taxes. These items should have been weighted equally between demand and commodity, the commission ruled. Both capacity and volume are cost factors or incidences in respect to the capital outlay for a pipeline project. Consequently, the commission held, reasonably accurate results can be achieved only by allocating the fixed expenses flowing from the capital outlay to both operating functions, capacity and volume.

The determination of how much of the fixed cost is assignable to demand or volume involves judgment, since the facts upon which it is to be made are not susceptible to mathematical computation. Both functions are very significant and neither predominates. Therefore, the commission ruled, these cost factors should be weighted equally. In this manner all gas transported by the pipeline will share in all of the expenses incurred in its transportation.

Some of the companies' customers are served exclusively with gas from a 20-inch line, whereas others will be served exclusively from a 26-inch line. There is a considerable variation in the heating value of the natural gas delivered to the several customers. The commission found that the companies were unduly discriminating between customers in demanding and receiving uniform volumetric rates regardless of the substantial variations in the heating value of the gas delivered. The rates which the examiner found reasonable would, when coupled with a heat content adjustment provision, result in higher rates for some customers. The rates as a whole, however, would produce smaller total revenues when applied to all customers. The commission held that it had no power to order an increase in the cost of gas to certain customers, which would result by the application of the rates and charges found to be just and reasonable as to other customers, when coupled with a heat content adjustment provision. Accordingly, it prescribed rates which would eliminate any increase to individual customers.

The prescription of rates which, when coupled with a heat content adjustment provision, would result in an increase in the average cost of gas to certain customers, was said to be prohibited by § 5 of the Natural Gas Act, even though the uniform application of such rates would result in an estimated decrease in the cost of gas to other customers. *Re Atlantic Seaboard Corp. et al. Docket Nos. G-1384, G-1175, Opinion No. 225, April 25, 1952.*

## Civil Aeronautics Board Explains "Temporary Mail Pay"

THE Civil Aeronautics Board, in overruling an air carrier's contention that its temporary mail rates should include an element of return on invest-

ment, pointed out that this argument ignores the fundamental difference between temporary and final mail rates.

Temporary rates, the board said, are just payments on account designed to take care of the carriers' pressing needs pending a determination of the final rate which will be applied to the entire period. One of the reasons for keeping mail pay down, the board observed, is to prevent overpayment and the need for subsequent recapture of advances. *Re Trans World Airlines, Inc. Docket No. 2375, May 5, 1952.*

## Other Important Rulings

The Florida Supreme Court reversed a commission order authorizing operation of a motorbus between a military airfield and the operator's resort, with one intermediate transfer point, where existing service was adequate between the airfield and the transfer point, the success of the resort business was the primary concern, and there was no evidence that a through service was necessary. *Panama City Transit Co. v. Railroad and Public Utilities Commission, 58 SE2d 313.*

The Massachusetts Department of Public Utilities authorized increased railroad commutation fares for a period of one year, after which time the railroad would be required to show that service had been improved or that it had an immediate program looking to that end. *Re Boston & Maine Railroad, DPU 9564, April 14, 1952.*

The Mississippi Supreme Court held that a statute providing that a railroad be civilly liable for discrimination for charging more for short- than for long-haul operations, unless authorized or sanctioned by the commission, had no application in an action for refund of railroad freight rates where the freight charge complained of had been authorized and sanctioned by the commission. *Cobb Bros. Const. Co. Inc. v. Gulf, M. & O. R. Co. et al. 57 So2d 570.*

The Wisconsin commission denied proposed electric rates because existing rates, which would yield a return of 6.8 per cent, were considered fair and reasonable. *Re St. Croix Falls-Wisconsin Improv. Co. 2-U-3723, May 2, 1952.*

The Missouri commission said that it is sometimes necessary for a transportation system to operate a line without making a profit, especially where the revenue and expenses of such operation are approximately even, but it held that a bus company should not be required to extend service where such operations result in a loss and an undue burden upon the remainder of the system. *St. Louis v. St. Louis Pub. Service Co. Case No. 12,247, March 11, 1952.*

The Ohio Supreme Court held that the commission has no power to issue an order restricting the speed of freight trains. *New York C. R. Co. v. Public Utilities Commission, 105 NE2d 37.*

The Colorado commission held that although the commission's duty is to protect certificated carriers, another certificated carrier should be authorized to extend service in order to give a full and complete service for the needs of the territory, especially when shippers testify that there is not adequate common carrier service to take care of their shipping needs. *Re Dillehay, Application No. 11671-Extension, Decision No. 38469, April 21, 1952.*

The Colorado commission held that a motor carrier certificate providing that a carrier should not engage in any transportation service of competitive character between towns along the line of common carriers on a certain highway meant "except in competition with scheduled line-haul carrier service between the towns." *Re Courtright (Courtright Transfer) Application No. 11668-Clarification, Decision No. 38546, April 28, 1952.*

The Missouri commission held that the primary issue to be considered in determining whether or not an agency station should be discontinued is whether or not the public generally is making sufficient use of the station to justify continued operation. *Re Wabash R. Co. Case No. 12,236, March 26, 1952.*

The Missouri commission authorized the substitution of a prepaid station for an agency station, although substantial revenue was produced from the station, because the method proposed by the railroad for the handling of freight (there being no passenger service rendered) would cause little or no inconvenience to the public. *Re Thompson (Missouri P. R. Co.) Case No. 12,248, March 25, 1952.*

The Wisconsin commission, in authorizing a return of 6.3 per cent on a gas company's rate base, indicated that it did not consider that the company's earnings of about 9.3 per cent on its total common stock equity, including estimated average surplus balance, were excessive. *Re Wisconsin Southern Gas Co. 2-U-3714, April 29, 1952.*

The Missouri commission held that a railroad owes no common carrier obligation either to the United States or to the general public to transport the United States mail. *Re St. Louis-S.F. R. Co. Case No. 12,253, March 24, 1952.*

The New Jersey commission held that a railroad's failure to earn an adequate return from passenger service operated on a line which is part of its system is not sufficient ground, standing alone, for the discontinuance of certain passenger service. *Re Pennsylvania R. Co. Docket No. 6006, April 23, 1952.*

The Wisconsin commission held that proposed telephone rates that would yield a return of 6.15 per cent were fair and reasonable. *Re Union Teleph. Co. 2-U-3745, April 25, 1952.*

The Missouri commission rejected a power company's request for a rate increase which would provide a return of 6.94 per cent on an average cost less depreciation rate base, but authorized rates which would provide a return of 6.35 per cent. *Re Arkansas-Missouri Power Co. Case No. 12,192, March 26, 1952.*

# Titles and Index

**Preprints in This Issue of Cases to Appear in PUBLIC UTILITIES REPORTS**

## Titles



## Index



*Public Utilities Reports (New Series)* are published in five bound volumes a year, with the PUR Annual (Index). These Reports contain the cases preprinted in the issues of PUBLIC UTILITIES FORTNIGHTLY, as well as additional cases and digests of cases. The volumes are $7.50 each; the Annual (Index) $6.00. *Public Utilities Reports* also will subsequently contain in full or abstract form cases referred to in the foregoing pages of "Progress of Regulation."

# Re Wisconsin Electric Power Company

2-U-3691
April 25, 1952

APPLICATION *for authority to increase electric rates; granted subject to commencement of actual operation of new generating plant.*

*Valuation, § 36 — Rate base determination — Net investment cost.*

1. Net investment cost was approved as a rate base standard, p. 100.

*Valuation, § 36 — Rate base determination — Net investment cost.*

2. The Commission is not required by law to give consideration to standards of value other than investment cost in rate cases, p. 100.

*Valuation, § 225 — Rate base determination — Proposed additions.*

3. An electric generating plant may be included in an electric company's rate base only if the rate relief to be granted is deferred until such time as the plant is in actual and permanent operation, and only after confirmation by the Commission, p. 100.

*Return, § 87 — Electric company.*

4. A return of 6 per cent was considered just and reasonable for an electric company, p. 104.

*Return, § 35 — Effect of inflation — Value of dollar.*

5. Existing stockholders in a public utility company are not entitled to receive a return which compensates them for declines in the value of the dollar, p. 104.

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*Return, § 24 — Attraction of capital — Inflation.*

Discussion of "capital attraction standard" as affected by inflation, p. 108.

By the COMMISSION: On November 16, 1951, the Commission initiated an investigation on its own motion of the rates and operations of Wisconsin Electric Power Company. On December 3, 1951, the company filed an application for an increase in rates.

Hearings thereon were held at Madison before Chairman John C. Doerfer, and Commissioners W. F. Whitney and James R. Durfee on December 17, 1951, January 4, 9, 10, 11, and 23, 1952, and February 13 and 14, 1952. Oral argument was presented before the full Commission on March 3, 1952, by Martin Paulsen and Van B. Wake, counsel for the company, and Harry G. Slater, counsel for the city of Milwaukee. A brief was filed by Shaw, Muskat & Paulsen on behalf of the company.

APPEARANCES: Wisconsin Electric Power Company, by Shaw, Muskat & Paulsen, by Martin R. Paulsen, Van

B. Wake; city of Milwaukee, by Walter J. Mattison, City Attorney, by Harry G. Slater, First Assistant City Attorney; Electrical Workers Union 494, A. F. of L., by E. Fransway, Milwaukee; United Office Sales & Technical Workers, by B. M. Feinberg, Milwaukee; city of Wauwatosa, by Milton L. Burmaster, City Attorney; City of West Allis, by George A. Schmus, City Attorney; city of Glendale and village of River Hills, by C. R. Dineen, Attorney, Milwaukee.

Of the Commission staff: W. E. Torkelson, Chief Counsel; A. R. Colbert, Chief, accounts and finance department; H. J. O'Leary, Chief, rates and research department; R. E. Purucker, engineering department.

## *Opinion*

The company's request for an immediate annual increase of $3,500,000 is denied.

After the initial unit of the Oak Creek power plant is placed in actual service, the company is authorized, upon confirmation by the Commission, to increase rates $2,223,000 annually which will provide additional net operating income of $991,138.

When the rates ordered herein become effective, the company will earn a return of 6.01 per cent on a net investment cost rate base of $168,027,190.

The rate base includes the first unit of the Oak Creek plant estimated to cost $24,500,000 and to be in operation by the end of 1952. Revenues and expenses have been adjusted to the 1952 year-end level of operations and include the economies anticipated from the operation of the Oak Creek plant.

### *Statement of the Issues*

The issues in this case are whether the present rates are just and reasonable and nondiscriminatory, and, if not, what rates are just and reasonable.

### 1. *Applicant's Claim for $3,500,000 Rate Increase*

The applicant's claim for a $3,500,000 rate increase is based upon a pro forma adjustment of its operations for the year ended October 31, 1951, to reflect inclusion in expenses and the rate base of Unit 1 of the Oak Creek generating plant and other major additions as set forth below:

ELECTRIC UTILITY
12 MONTHS ENDED OCTOBER 31, 1951

| | Per Books | Adjustments | Pro Forma |
|---|---|---|---|
| Operating revenues | $56,204,327.22 | | $56,204,327.22 |
| Operating expenses and taxes | | | |
| Operating expenses | 25,631,008.59 | [1]$1,141,700 | 31,105,576.73 |
| Maintenance | 4,732,868.14 | [2](400,000) | |
| Taxes other than income | 4,808,604.27 | [3](1,030,500) | 4,522,104.27 |
| | | [4]744,000 | |
| Provision for income taxes | 7,525,880.00 | [5](1,164,680) | 6,361,200.00 |
| Depreciation | 4,846,162.18 | [6]1,026,000 | 5,872,162.18 |
| Total operating expenses and taxes | $47,544,523.18 | $316,520 | $47,861,043.18 |
| Net operating revenues | 8,659,804.04 | (316,520) | 8,343,284.04 |
| Income from leased utility plant | 58,775.07 | — | 58,775.07 |
| Utility operating income | $8,718,579.11 | $(316,520) | $8,402,059.11 |

| Utility Capital | Per Books | Adjustments | Pro Forma |
|---|---|---|---|
| Physical property | $190,388,800 | [7]$31,687,499 | $222,076,299 |
| Less: Depreciation reserve | 65,750,525 | [8]1,026,000 | 66,776,525 |
| Net physical property (end of period) | $124,638,275 | $30,661,499 | $155,299,774 |
| Materials and supplies | 7,381,301 | [9]1,500,000 | 8,881,301 |
| Working capital | 3,795,485 | [10]92,713 | 3,888,198 |
| Total | $135,815,061 | $32,254,212 | $168,069,273 |
| % return earned | 6.42 | | 5.00 |

Notes:
[1] Increased payroll costs.
[2] Estimated net annual savings from operation of Oak Creek Unit #1.
[3] Electrical energy tax removed.
[4] Added ad valorem tax—due to property additions.
[5] Increased income tax rates, and adjustments of book income and proposed refinancing.
[6] Annual increase in accrual plus accrual on additional depreciable property.
[7] Estimated cost of major projects under construction at October 31, 1951.
[8] Increase in depreciation reserve.
[9] Additional fuel stock for Oak Creek plant.
[10] Increase in working capital resulting from adjustment in operating expenses.

On the basis of the foregoing pro forma statement, a rate increase of $3,500,000 annually would increase utility operating income by $1,560,500 from $8,402,059 to $9,962,559. The increased income represents a return of 5.93 per cent on the pro forma rate base of $168,069,273.

The applicant claimed that the pro forma return of 5 per cent was unreasonably low and that increased income was required to attract capital for property additions now under way and other large additions in the immediate future.

The company also submitted an estimated summary of results of operation for the calendar year 1952 which is set forth below:

| | |
|---|---|
| Operating Revenues | $60,590,200 |
| Operating Expenses and Taxes | |
| Operating Expenses | 29,036,000 |
| Maintenance | 5,470,000 |
| Taxes Other Than Income Taxes | 4,237,000 |
| Income Taxes | 7,686,600 |
| Depreciation | 5,183,000 |
| Total Operating Expenses and Taxes | 51,612,600 |
| Net Operating Revenues | 8,977,600 |
| Income from Leased Utility Plant | 24,340 |
| Utility Operating Income | $9,001,940 |

| | |
|---|---|
| Utility Capital | |
| Physical Property | 223,900,000 |
| Less Depreciation Reserve | 68,450,000 |
| Net Physical Property (At end of period) | 155,450,000 |
| Materials and Supplies | 8,660,000 |
| Working Capital | 4,310,000 |
| Total | $168,420,000 |
| Per Cent Return Earned | 5.34 |

The foregoing statement reflects:

(1) An increase in kilowatt-hour sales of 8.1% over 1951.
(2) An increase of 6.6% in revenues over 1951.
(3) An increase of 50¢ per ton in the cost of coal.
(4) An increase of 6% in labor charged to operations.
(5) An increase of 10% in the cost of maintenance materials.
(6) An increase in ad valorem taxes.
(7) Inclusion of unit #1 at Oak Creek in the rate base.

The income statement covers the calendar year 1952 whereas the rate base used in determining rate of return is as of the end of the period. The addition of $1,560,500 of net operating income to be obtained from the $3,500,000 rate increase would produce total net operating income of $10,562,440. This would yield a return of 6.27 per cent on the claimed rate base of $168,420,000.

The applicant also submitted esti-

mates of replacement costs and current values of its property and plant. These estimates and the corresponding book values are set forth below:

| Witness | Description of Estimate | Estimate | Book Value |
|---|---|---|---|
| Seybold | Replacement value .................. ......... | $314,239,567 | $185,102,451 |
| Dorau | Current value based on construction costs ...... | 355,224,100 | 186,147,100 |
| Dorau | Current value based on consumers price index . | 271,780,000 | 186,147,100 |

Although the company did not complete rate base calculations with any of the above amounts, it very forcefully urged the Commission to give consideration to reproduction cost or current cost in determining a rate base.

The company also contended that the Commission allow a return of 7.75 per cent on past cost rate base or 6.25 per cent on a current cost rate base.

*Rate Base*

[1–3] This Commission approves net investment cost as a rate base standard.

While the company has based its claim for a $3,500,000 rate increase upon original cost rate base as of the end of 1952, it has also submitted an estimate of reproduction cost, and certain data relative to current cost. The company's original cost electric utility rate base as of the end of 1952 totals $168,027,190 and includes the estimated cost of the first 120,000 kilowatts generating unit at the Oak Creek plant.

Based upon various replacement cost factors, the company submitted an estimate of the replacement cost of its electric property as of October 31, 1951. For depreciable property this amount totaled $314,239,567 as compared with actual cost of $185,102,451. The company did not complete the rate base calculation by deducting accrued depreciation nor did it submit any present or prospective rate of return calculations based upon a replacement cost rate base.

Mr. Herbert B. Dorau, chairman of the Department of Public Utilities and Transportation, New York University, likewise submitted some estimates of value of the company's electric utility property, without deduction of depreciation, in terms of dollars of constant purchasing power. Thus he determined that as of October 31, 1951, the value in terms of a composite construction cost dollar was $355,224,100, and if expressed in terms of the value of the consumers' dollar, the current value would be $271,780,000.

The Commission has just recently passed upon this problem in its decision of Re Wisconsin Teleph. Co. (1952) 2-U-3573, 93 PUR NS —. However, in this case, counsel for Wisconsin Electric Power Company has seriously urged that the Commission is required by law to give consideration to standards of value other than investment cost. In answer to company counsel and as a preface to what was stated in the Wisconsin Telephone Company decision, the Commission points out the following statement of the Wisconsin supreme court in Pabst Corp. v. Railroad Commission (1929) 199 Wis 536, 540, 227 NW 18:

"Shortly after the Commission filed that decision (Pabst Corporation Case), this court in Waukesha Gas & E. Co. v. Railroad Commission, 19 Wis 565, PUR1927B 545, 211 NW

760 modified its expressions in the earlier case of Waukesha Gas & E. Co. v. Railroad Commission, 181 Wis 281, PUR1923E 634, 194 NW 846, but did not intend to withdraw what was said in that case any farther than was necessary to conform to the Federal rule announced in McCardle v. Indianapolis Water Co. (1926) 272 US 400, 71 L ed 316, PUR1927A 15, 47 S Ct 144. So far as the conclusion in Waukesha Gas & E. Co. v. Railroad Commission, *supra,* was out of harmony with that Federal rule, it was modified; otherwise the conclusions reached in that case stand."

The Commission concludes that the foregoing statement of the Wisconsin supreme court when considered in conjunction with the cases cited below effectively refutes the contention of counsel for the company, that this Commission is required by law to give consideration in rate cases to standards of value other than investment cost.

Since the Commission has just recently (April 9, 1952) passed upon the rate base standard in the Wisconsin Telephone Case, *supra,* we repeat below the relevant parts of that opinion:

"The issue as to proper valuation of property for rate-making purposes has a long history of controversy since the historic decision of the United States Supreme Court in Smyth v. Ames (1898) 169 US 466, 42 L ed 819, 18 S Ct 418. From 1898 and until the United States Supreme Court decision in Federal Power Commission v. Hope Nat. Gas Co. (1944) 320 US 591, 88 L ed 333, 51 PUR NS 193, 64 S Ct 281, regulatory Commissions were urged to apply various and often inconsistent theories of valuation depending upon the prevailing price levels. If original costs were higher than the general price level, the utilities then persuaded some Commissions and courts to adopt the original cost theory of valuation; if the general price level at the time of a rate case were higher than original costs, then contrary theories were urged by the utilities and often adopted. A single consistent valuation theory thus seemed impossible of attainment.

"The Hope Case gave recognition to the importance of the result to be reached, that is, the opportunity for a utility to earn reasonable profits sufficient to attract capital rather than the mechanics employed in reaching such result. Commissions were not bound to a single formula or combination of formulas. If a Commission can do a good job, as well as a quicker and a less expensive one, in a rate case by the adoption of any method which would retain the fundamentals of fair play, due process, and provide fair and reasonable results, it is now free to do so under the Federal Constitution.

"Traditionally, this Commission has long espoused the investment cost method of establishing the rate base. See Waukesha Gas & E. Co. v. Railroad Commission, 181 Wis 281, 301, PUR1923E 634, 194 NW 846. Since the Hope Case, this Commission has considered that it is completely free to rely exclusively on the investment cost standard, so long as the rate of return applied to that standard achieved the required reasonable end result. This has been recognized as the law in Wisconsin long before the United States Supreme Court decided the Hope Case in 1944. In Wiscon-

sin-Minnesota Light & P. Co. v. Railroad Commission, 183 Wis 96, 99, PUR1924C 534, 537, 197 NW 359, the Wisconsin supreme court stated 'It is not its method that is to be reviewed, but the result reached by the Commission. The statute charges the Commission with the duty of ascertaining and declaring a reasonable rate. If that is done, the method by which the Commission arrives at the result is not subject to criticism.' See also Waukesha Gas & E. Co. v. Railroad Commission, 181 Wis 281, PUR 1923E 634, 194 NW 846. Subsequently, by reason of United States Supreme Court decisions requiring consideration be given to cost of reproduction new less depreciation because of supposed requirements of the Federal Constitution our supreme court modified the Wisconsin rule to conform thereto, but no further. Waukesha Gas & E. Co. v. Railroad Commission, 191 Wis 565, PUR1927B 545, 211 NW 760. The Hope Case had the effect of freeing regulatory Commissions from the requirement in former decisions of the United States Supreme Court requiring consideration be given to reproduction cost new less depreciation, so that in this state the law is as it was formerly. Pabst Corp. v. Railroad Commission (1929) 199 Wis 536, 227 NW 18.

"The applicant contends that the Commission is charged by law with finding 'the fair value of the property used and useful . . .'; that this requires the Commission to give a realistic albeit a partial consideration to the applicant's 'current value' theory; that 'current value' is not the same as 'reproduction cost'; that the applicant would not urge this Commission to consider even current value except for the fact that the present price level does not reflect merely a high point in a price cycle but rather that it represents a new level or plateau of an enduring and permanent nature. Accordingly the applicant urged that this Commission recognize that 'informed' investors seeking securities as a hedge against inflation would leave the public utility security markets and invest in other securities which would hold some promise of protection against inflation. Such a flight from the utility investment market would increase the cost of utility capital to the ultimate detriment of the public.

"This Commission does not wish to be arbitrary in rejecting a current value theory and in adhering to the net investment cost theory. It is motivated primarily by practical considerations. The main objections against the reproduction cost theory are inherent in the current value theory. Both lack definiteness and stability. The use of current value would reintroduce the wild uncertainty and recurrent rate controversies which characterized the reproduction cost era. The most serious vice would be that the use of such variable standards never lead to stability. As early as 1908, this Commission said: 'Rates based upon valuations that rest on current prices, would necessarily have to be changed with all changes in these prices. This would manifestly be impracticable and, perhaps, also unjust both to the plant and its customers. Prices of practically every element that enters into a plant are moving up and down so often that under no known method could the rates be changed and applied with equal frequency . . .

Rates should be as permanent as possible under the circumstances. Frequent changes in them are disturbing both to the plants and to their customers . . . In order to secure the greatest possible permanency in the rates, it is necessary that the valuation upon which they rest should be subject to the fewest possible fluctuations.' Hill v. Antigo Water Co. (1909) 3 Wis RCR 623, 639. To the same effect, see the opinion of Justice Brandeis in Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Service Commission, 262 US 276, 308, 67 L ed 981, PUR1923C 193, 43 S Ct 544, 31 ALR 807.

"In the language of Chief Justice Rosenberry in Wisconsin Teleph. Co. v. Public Service Commission (1939) 232 Wis 274, 355, 30 PUR NS 65, 121, 287 NW 122: '. . . it is difficult to see why a valuation arrived at by guess on the basis of estimates should form the legal basis for depriving a litigant of its property, or be the justification for excessive charges to the public.'

"During the present period of inflation, the Commission is being urged to consider rate bases which are geared to the present purchasing power of the dollar rather than original cost. While it may be possible to estimate with a considerable degree of accuracy how much an existing plant would cost in terms of present-day dollars, what do you have when you obtain that amount? It certainly does not represent past dollar investments; it is not claimed that it represents reproduction cost. It would appear that current cost only represents in terms of today's dollars what it would have cost to build the plant as it was built over a period of many years. While such information is interesting and certainly demonstrates the extent to which the purchasing power of the dollar has declined because of current inflation, it affords no basis whatsoever for the establishment of public utility rates. If faced with the necessity today of building with current dollars a plant such as that of the Wisconsin Telephone Company it is safe to say that there would be some changes made, and that the magnitude of those changes would be such as to afford no valid basis of comparison between such a plant and the present plant. Under all the circumstances, the Commission does not consider that current cost is entitled to any weight in arriving at a rate base for this company. The magnitude of the additions to this company's property since World War II and prospective future additions are such as to reflect in book costs, to a considerable degree, the inflation which has taken place in recent years.

"In effect, what the applicant seeks is to obtain a higher rate of return by use of an inflated rate base, without having that rate of return expressed in a numerical percentage which would appear to be much higher than the returns heretofore approved by this Commission. The Commission is willing to go on record at this time that it will approve any rate of return on a net investment cost rate base which is deemed necessary to achieve the reasonable end result required under the Hope Case. The Commission conceives no necessity for attempting to beguile or befuddle the public by applying seemingly low rates of return to inflated rate bases.

"By adopting a certain and a well-understood value of plant for rate-making purposes, a Commission can avoid uncertainty, guesswork, unnecessary expense, repetitious rate cases, and a waste of time. It is justified in doing so both under the Federal Constitution and the Wisconsin law."

In this proceeding, the company has raised an issue as to the relationship of the date for which a rate base is determined to the period covered by the income statement. Apparently, the company takes the position that in a period when property additions are being made rapidly, the rate base date should be the end of the period covered by the income statement. Normally, property additions increase service capacity, and if additional service is required by customers, such additions produce increased revenues. In the case of electric utilities, there is a considerable variation in revenue production by investments in different types of equipment. Some investments produce no additional revenues but, on the other hand, may because of improvement in design or efficiency bring about reductions in operating expenses. In a relatively few cases, additional investment may produce neither increased revenues nor decreased expenses. For the most part, however, either additional revenues or reduced expenses flow from property additions.

The normal method of giving consideration to the effect on revenues and expenses resulting from property additions is to calculate an average rate base for the period covered by the income statement. When property additions are substantially uniform throughout the period, both the company and its customers are treated fairly by such a procedure. In this case, the company has insisted upon use of a rate base as of the end of the income period. Its course of action apparently has been guided by the fact that the first generating unit of the Oak Creek plant and associated transmission facilities representing an investment of about $25,500,000 is scheduled to be completed and in operation by the end of 1952. Furthermore, the company considers that even disregarding future load growth, this unit is required to restore the margin of safe capacity required for existing loads.

Since October 31, 1951, several million dollars have already been expended on plant additions, and the balance of the investment is firmly committed and being made in accordance with a scheduled completion date at about the end of 1952. The Commission considers that in view of all the circumstances Oak Creek Unit 1 may be included in the rate base only if the rate relief to be granted is deferred until such time as the plant is in actual and permanent operation and only after confirmation by the Commission. Inclusion before actual operation would require customers to pay more for service than would be warranted by the actual property and plant utilized in the rendition of such service.

The rate base at the end of 1952 including Oak Creek Unit 1 will be $168,027,190.

*Rate of Return*

**[4, 5]** The Commission concludes that a rate of return of 6 per cent is just and reasonable.

Testimony relative to rate of return was presented for the applicant by Her-

bert Dorau of New York University and Clarence Bickel, vice president and treasurer of Robert W. Baird & Company, Ltd., and Asel R. Colbert, chief, accounts and finance department, for the Commission staff.

In arriving at a historical cost of capital as of October 31, 1951, Mr. Dorau determined that the historical cost of debt capital was 2.912 per cent. Included in this amount is the annual amortization to maturity of so-called "imbedded refinancing costs" of $3,742,000 applicable to prior bond issues refunded by the $50,000,000 of $2\frac{5}{8}$ series bonds issued in June, 1946. If these "imbedded" costs were excluded, the historical cost of debt capital, according to Dorau, would have been 2.66 per cent.

In a similar manner Dorau estimated the historical cost of preferred stock capital as being 4.722 per cent. Without inclusion of "imbedded" costs heretofore written off, the cost would have been 4.013 per cent.

In estimating historical cost of common stock capital, Mr. Dorau determined for each year of the period 1940–1950 earnings-price ratios applicable to Wisconsin Electric Power Company stock and the stocks of seven other principal electric utilities. Dividend yields were likewise determined for the same period. The ratios of the price-earnings ratios and dividend yields of Wisconsin Electric Power Company to the 7 large electric utilities were utilized by Dorau in constructing an indexing factor to be applied to annual earnings requirements for each year. By utilization of these factors plus an added adjustment of 20 per cent to reflect market pressure and cost of financing requirements, Dorau arrived at an estimated historical cost of 14.5 per cent for common stock capital of Wisconsin Electric Power Company.

After inclusion in common stock equity of $5,967,000 of so-called "imbedded" costs previously written off, Dorau arrived at an over-all historical cost of capital of 7.10 per cent applicable to the allocated investment in the electric utility operations of Wisconsin Electric Power Company, as follows:

| | % of total capital | Rate | Weighted cost |
|---|---|---|---|
| Funded debt .... | 49.5% | 2.91% | 1.44% |
| Preferred stock.. | 17.0 | 4.72 | .80 |
| Common stock .. | 33.5 | 14.50 | 4.86 |
| Total ......... | 100.0% | | 7.10% |

Based upon various indices and relationships from recent financing, he concluded that the estimated current replacement cost of debt capital at October 31, 1951, would be 3.20 per cent. In a similar manner, he estimated a current replacement cost of 4.60 per cent for preferred stock. By using a somewhat similar procedure, he estimated a current replacement cost of 10.5 per cent for common stock. By applying the above costs to an assumed capitalization structure, he arrived at 6 per cent for current replacement cost of capital, as set forth below:

| | % of total capital | Rate | Weighted cost |
|---|---|---|---|
| Funded debt ..... | 47.5% | 3.2% | 1.52% |
| Preferred stock .. | 17.5 | 4.6 | .80 |
| Common stock ... | 35.0 | 10.5 | 3.68 |
| Total ......... | 100.0% | | 6.00% |

Mr. Dorau found a historical cost of capital of 7.10 per cent, as shown previously. However, he concluded

that the rate of return applicable to a past cost rate base should be in excess of that amount, principally to reflect a consideration for the decline in the purchasing power of the past stockholder investment due to current inflation. In effect, he increased the weighted current cost estimate of 3.68 per cent for common stock capital by 46 per cent to reflect current requirements for equity capital. The 46 per cent is derived from applying the consumers' price index to the nominal dollar property investment year by year since 1913. When the revised weighted equity cost of 5.3 per cent is added to the past cost of debt and preferred stock capital, a figure of 7.69 per cent is obtained. He rounded this to 7.75 per cent, reflecting his estimate of fair return applicable to a past cost rate base.

Mr. Dorau also concluded that a return of 6.25 per cent would be fair and reasonable if applied to a rate base adequately reflecting present costs or the investment in terms of present legal and economic size dollars. While Dorau did not actually compute a current cost rate base, he did offer two indices for measuring the cost of the property in terms of current dollars. One index based upon application of the Department of Commerce construction cost index, when applied to year-by-year property additions since 1915, yields a composite amount of 190.8. The other index, the consumer price index of the Bureau of Labor, when applied in a similar manner, produces a composite of 146 per cent.

Mr. Bickel testified that in his opinion, assuming a dividend rate of $1.30 per share, and a payout ratio of 70 per cent, earnings per share should be not less than $1.86. Although he did not testify regarding a rate of return for total capital, Exhibit 10 shows that his estimate of required common stock earnings, when added to interest and preferred dividend requirements, would indicate a total return of 5.6 per cent on pro forma capital as of October 31, 1951. Conversely, Dorau's estimate of a 7.75 per cent total return requirement, after deducting preferred dividends and interest, would provide common earnings of $2.95 a share equal to 16.48 per cent on the pro forma book value shown in Exhibit 10.

The approach adopted by Mr. Colbert in determining a reasonable rate of return was to determine the actual cost of debt and preferred stock capital. This cost is adjusted, however, to reflect the fact that additional debt capital would be required in the very near future, and that the cost of such debt capital would be greater than that experienced in recent years. In determining the cost of common stock capital, consideration was given to the anticipated costs to be experienced in the immediate future, due in part to the contemplated issuance of additional common stock. In a word, Colbert proposed a rate of return which he considered would cover the cost of capital and promote the attraction of additional capital to finance necessary additions and improvements required for reasonably adequate service to the public.

Mr. Colbert arrived at an estimate of 10.50 per cent as the required earnings on common stock capital. This represents a judgment figure supported, however, by several methods which are commonly applied by market analysts in estimating common stock

earnings requirements. He first determined that a 70 per cent dividend payout would be fair and reasonable. This ratio was accepted after giving consideration to the security structure of Wisconsin Electric Power Company, dividend payouts of other leading electric utilities of the United States, and current conservative financial practice. After determination of a 70 per cent payout, three methods were considered as bearing upon the amount of common stock earnings required, as follows:

(1) Dividend yields on net issue price of 1949 and 1950 common stock issues.

(2) Dividend yield on market value.

(3) Dividend rate, per cent payout and book value.

All three methods produced results within a narrow range supporting a 10.50 per cent earning requirement on common stock.

The application of actual cost of debt and preferred stock capital, and 10.50 per cent to common stock capital, would produce an over-all cost of capital of 5.75 per cent based on corporate capital only, as set forth below:

| | Amount | % Total Capital | Rate | Total Cost |
|---|---|---|---|---|
| Common stock equity | $58,186,039 | 35.6% | 10.50% | $6,109,534 |
| Preferred stock | 30,450,800 | 18.6 | 3.95 | 1,203,048 |
| Debt | 75,000,000 | 45.8 | 2.67 | 2,000,919 |
| Amortization of capital stock expense—15 years | — | — | — | 71,574 |
| Total | $163,636,839 | 100.0% | 5.74% | $9,385,075 |

However, in view of the imminent additional financing at higher anticipated cost, the above rate was adjusted by adding in $26,000,000 of new financing at an estimated average cost of 6.94 per cent. This percentage was based upon a cost of 3.375 per cent for debt financing of 50 per cent of the total and 10.50 per cent for common stock financing. After including the anticipated higher cost of new and additional financing, Mr. Colbert concluded that a return of 6 per cent would be fair and reasonable.

Since the conclusion of the hearings in this proceeding, the company has made application to the Commission, in docket 2–SB–491, for authority to issue 702,485 shares of common stock and $12,500,000 of bonds. Although the final issue price of the securities has not been set, data in the company's application show an estimated issue price of $20 a share, which, according to the Commission's decision of April 7, 1952, in 2–SB–491, "appears to be conservative, and it may be that a larger premium may be obtained . . . ." However, using the $20 a share estimate of net proceeds, the dividends of $1.30 a share indicate a yield on issue price of 6.50 per cent, which, with a 70 per cent payout ratio would mean common earnings requirement of about 9.3 per cent.

A review of the testimony concerning fair rate of return indicates that Mr. Colbert, Mr. Bickel, and Mr. Seybold of the company arrive at about the same conclusion. The principal

conflict between Colbert and Seybold lies in the relationship of the income period to the date of the rate base. Mr. Dorau concludes that a much higher rate of return than the one proposed by Colbert and inferred by Bickel is required. In fact, Mr. Dorau's return requirements are far in excess of those presented by company officers, and would require a rate increase much greater than that requested by the company.

The heart of the disparity in rate of return between Mr. Dorau and the other witnesses lies in Dorau's definition of the capital attraction standard. Mr. Dorau stated:

"Mere ability to obtain additional capital in my opinion is not sufficient by itself, since it is obvious that additional capital can be obtained even though less than a fair return be issued. To be meaningful, the capital attraction standard must be understood to mean that additional capital could be obtained on terms and conditions which do not impair the value and integrity of past-invested capital. It also means that the prospective return must be sufficient to maintain the credit of an enterprise by holding out the chance of return for the future attraction as compared with prospective earnings on other currently available investments under similar conditions of risk and uncertainty. If the past investment has to underwrite or subsidize the cost of additional capital, the prospective return is less than fair and less than sufficiently attractive."

This definition of the "capital attraction standard" brings into sharp relief a basic and fundamental difference between Dorau and the other witnesses as to what the word "fair" in the term "fair return" really means. Dorau considers past investment as captive capital with no opportunity to hedge against the ravages of inflation. In contrast, uncommitted capital has alternative investment opportunities. Dorau then concludes that ". . . if fairness means anything it must imply a treatment of the past helpless investment which is appropriate in the light of conditions now prevailing." By this statement Dorau imputes a breadth and scope to the term "fair return" far beyond anything which can be inferred from the established legal and economic concept of regulation in this country up to this time. Acceptance of his definition requires an entirely new concept of the risk component in equity investments in public utilities. Stability of dollar earnings and relative security of investment have been features of utility investment which have been sought after by both investors and those charged with the duty of regulation. Because of these characteristics, over the long term, utilities have been able to secure equity capital at relatively low costs. However, up until very recently, it is doubtful whether either investors or regulators gave any serious thought to the maintenance of the integrity of past investments against declining purchasing power of the dollar.

The ability of utilities to continue to attract equity capital at favorable rates during the current inflationary period is indicative of the fact that there still remains a substantial segment of the investing public to whom the attractiveness of stability of earnings and security of investment outweighs the attractiveness of an inflation hedge.

The mere existence of inflation hedge possibilities negates the twin objectives of stability and security. Investors attempting to hedge against inflation are relying upon a concomitant high level of industrial activity to maintain a relatively constant purchasing power of the return on their investment during an inflationary period. Unlike the investor in a public utility, they face a very real risk that with deflation, earnings in terms of purchasing power may drop sharply or disappear and that even the investment itself may not be secure. Recent and current market history clearly shows the existence of sufficient diversity of investment interest to absorb at reasonable costs, the equity requirements of regulated utilities. When, as, and if, the investing public evidences a shift in investment preferences, the Commission will of necessity give recognition to their demands. Currently, "we accept the verdict of the market place."

Mr. Dorau contends that existing stockholders in a utility company should receive a return which compensates them for declines in the value of the dollar. This amounts to a plea for an escalator clause corresponding to the cost-of-living clauses in union wage contracts and roughly analogous to the farm product parity pricing policies of the Federal government. However, during any period of great price inflation, there remains a very large section of the public which is helpless to protect itself against the effects of inflation.

Among those who will remain unprotected against past or future inflation are the millions of people of small income. It is a well-known fact that the savings of these people are invested in fixed income or fixed dollar value type of securities such as savings bonds, insurance and annuity policies, savings deposits, individually held corporate bonds, preferred stocks and so forth. It is these people who would be discriminated against by a standard of utility rate making which undertakes to compensate utility common stockholders for price inflation. The effect of such a standard of rate making would be to merely shift the alleged discrimination from one class to another. It certainly would not reduce existing inequities. The only way to eliminate the inequities of inflation is to put everybody back on an equal footing. Obviously, this is beyond the power of a regulatory Commission. The refusal of this Commission to embark upon the course suggested by Mr. Dorau is not motivated by a lack of courage, but rather a conviction that to do so would only aggravate the inequities. Even among the investors in this company there would result a patent discrimination not only between the bond and preferred stockholders on the one hand and the common stockholders on the other, but also among the common stockholders themselves. It would result in a windfall to these who purchased stock with inflated dollars as against those who purchased stock with prewar dollars.

It is simply beyond the power of regulatory Commissions to cure inflation or equalize the inequities resulting therefrom. Apparently current purchasers of utility common stocks are either oblivious of or unconcerned with the need for inflationary hedges. So long as the "phenomena" of a willingness to buy utility common stocks on a comparatively low yield basis con-

tinues, a regulatory Commission cannot be regarded as an instrumentality of discrimination in being guided accordingly.

The company's claims with respect to the effect of inflation on the cost of capital are not supported in the security markets. Their claims are grounded principally upon speculation and conjecture as to how the market *ought* to react to inflationary tendencies rather than *actual* behavior. This Commission prefers to accept the actual behavior of the market rather than speculate as to the future and as yet undisclosed preferences of investors. The basic laws of supply and demand and relationship of price to earnings, if considered a phenomena under present circumstances, still prevail in the securities. The investors themselves determine the cost of utility equity capital. The Commission is satisfied to let the verdict rest in their hands. When and if such investors require higher yields on public utility equity securities this Commission will accept such requirements.

The Commission is convinced from its review of the evidence that a 6 per cent return allowance for the company is sufficient. Under prevailing market conditions, such a return will permit the company to raise additional capital as necessary for public utility purposes at a reasonable cost, and including a proper proportion of equity capital.

*Revenue Requirements*

Since the Commission proposes to adopt a rate base as of December 31, 1952, in fairness to the ratepayers, the level of income to be associated with such a rate base should be the going level at the end of 1952. Since the company failed to supply such data upon request of the Commission staff, an estimate was prepared by Mr. Colbert and placed in evidence. This estimate as set forth in exhibits 18 and 19 is shown below:

ESTIMATED GOING LEVEL OF ELECTRIC UTILITY OPERATIONS AT END OF 1952 LEVEL

| | |
|---|---|
| Operating revenues | $62,999,900 |
| Operating expenses: | |
| Operation and maintenance | 36,060,945 |
| Depreciation | 6,082,300 |
| Taxes other than income taxes | 4,502,400 |
| Income taxes | 7,338,800 |
| Total operating expenses | $53,917,845 |
| Net operating income | 9,082,055 |
| Income from leased utility plant | 24,340 |
| Utility operating income | $9,106,395 |
| Rate base | |
| Electric utility plant | $223,900,000 |
| Less: depreciation reserve | 69,349,300 |
| Net plant (12/31/52) | $154,550,700 |
| Materials and supplies | 9,160,000 |
| Working capital | 4,316,490 |
| Total rate base | $168,027,190 |
| Per cent return earned—existing rates | 5.42% |

The foregoing data as presented by Mr. Colbert represents his adjustments of company Exhibit 9 to reflect year-end level of operations. The record discloses that Mr. Colbert had not adjusted expenses to reflect an increase in pension costs which would occur as a result of the increase in gross revenues. The net effect of this adjustment would be to increase expenses $30,121 before income taxes and $13,600 after income taxes. Thus, net operating income as shown above would be reduced from $9,106,395 to $9,092,795 and the rate of return reduced from 5.42 per cent to 5.41 per cent.

It should be pointed out that both revenues and expenses represent esti-

mates based upon informed judgment in the light of existing conditions. Since the rate base date is several months in the future, it was necessary to project both revenues and expenses for a longer period ahead than the Commission normally does in rate cases. It must be recognized, therefore, that the estimates may be either over or under actual realization. Thus, the company points out that to date its estimate of increased sales, particularly industrial sales, is greater than justified by the rate of increase so far this year. However, even this check of estimates is still eight months away from the base date. The future trend is somewhat complicated by the known fact that in the past few months a gap has developed, particularly in the general area served by this company, between the drop in civilian production resulting from reduced allocation of materials and the acceleration of the defense production program.

On the other hand, the company's forecasted increase of 50 cents per ton in the cost of coal anticipated as of April 1, 1952, did not materialize. An increase of 20 cents per ton in freight rates was authorized by the Interstate Commerce Commission April 11, 1952. At the present time, it does not appear that the estimates used herein will be far out of line. However, if any material deviation should take place, the Commission is in a position to act promptly as conditions may warrant.

In order to earn a 6 per cent return for the base period, it would be necessary to increase net operating income by $988,836. Because of the effect of state and Federal income taxes and an increase in pension accruals an increase in rates of $2,218,000 is required.

The Commission is satisfied and finds that under existing conditions revenues from existing rates are adequate and provide the company with a reasonable return on the property and plant actually utilized in the rendition of service. The increase in rates referred to above is warranted only after Oak Creek Unit 1 is placed in actual service.

*Proposed Rates*

To provide the $3,500,000 which it requested, the company submitted proposed schedules of rates. When related to the 1952 year end level of operations the proposed rates would yield $3,927,000 of additional revenue instead of the $3,500,000 based upon the 1951 level of operations.

The principal rate changes proposed by the company are:

(1) Reduce the number of rate areas for residential and commercial service from 5 to 4.

(2) Substitute commercial rates for residential rates for application to master-metered apartment buildings, flats, and rooming houses.

(3) Withdraw present flat rate for residential water-heating service and require such customers (about 5,000) to take service under the standard metered rate.

(4) Reduce the number of rate areas for farm service from 2 to one.

(5) Withdraw present optional farm rate (applicable to 127 customers).

(6) Substitute a general secondary rate for the present small commercial and industrial rate, the large users commercial secondary rate, the seasonal power rate, highway lighting

rate, and the battery charging, cooking, and refrigeration rate.

(7) Substitute one primary rate for the 3 present rates.

(8) Apply rates of charge in primary rate to sales to other utilities.

(9) Apply short-hour penalty to 11 named schools in Milwaukee on municipal primary rate.

(10) Increase the level of all rates so as to produce $3,500,000 of additional revenue based upon 1951 sales.

In addition, the company proposed to file subsequently a general revision of the terms and conditions applicable to its several rate schedules. If necessary this matter can and will be covered by supplemental order in these proceedings.

The Commission is agreeable to the changes proposed by the company in paragraphs (1) to (7) inclusive above. The proposals set forth in (8), (9), and (10) are rejected.

The rates hereinafter ordered will produce additional revenues of $2,223,000 on the basis of the 1952 year end level of operations. Utility operating income will be increased from $9,106,395 to $10,097,533 or a total of $991,138. This difference between $2,223,000 of rate increase and the increase in net income of $991,138 is absorbed principally by state and Federal income taxes and to a very minor extent by increased pension accruals.

The rates ordered herein will provide a more balanced rate structure than that which has prevailed heretofore. Differentials between rate areas have been reduced and differentials between residential and commercial rates likewise have been reduced. The new schedules will provide increases approximately as follows:

| | |
|---|---|
| Residential—general | $57,355 |
| Residential—water heating | 368,720 |
| General service—secondary | 368,923 |
| Commercial—water heating | 16,163 |
| Farm—general | 161,623 |
| Farm—water heating | 52,679 |
| General service—primary | 1,093,188 |
| Street and highway lighting | 62,672 |
| Other sales to public authorities | 21,972 |
| Sales to Greendale | 19,319 |
| Total | $2,222,614 |

## *Findings of Fact*

The Commission finds:

1. That the rate base as of December 31, 1952, computed from investment in plant less depreciation reserve plus allowance for materials and supplies and working capital is $168,027,190 which amount is just and reasonable.

2. That a return of 6 per cent on the rate base in finding 1 above is just and reasonable.

3. That in view of the investment already made and under commitment to be completed by December 31, 1952, it is just and reasonable to include in the rate base, the investment in Unit 1 of the Oak Creek power plant together with associated equipment. The increased rates authorized herein shall become effective only after this unit has been placed in actual operation.

4. Consistent with the foregoing findings it is just and reasonable to test revenue requirements by the use of the estimated going level of operations as of December 31, 1952.

5. That the increase in rates proposed by Wisconsin Electric Power Company is excessive and unreasonable.

6. That the rates ordered herein as set forth in Appendix A [appendix omitted herein] are just and reasonable.

7. That the proposed modifications

in rate structure set forth in paragraphs (1) to (7) inclusive under *Proposed Rates* hereinbefore stated are just and reasonable, and that the proposed modifications under paragraphs (8), (9), and (10) thereof are unjust and unreasonable.

*Conclusion of Law*

The Commission concludes:

That it has jurisdiction under §§ 196.03(1), 196.20, and 196.37 to prescribe rates set forth in Appendix A [omitted herein] and that an order should be entered so providing.

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*MASSACHUSETTS DEPARTMENT OF PUBLIC UTILITIES*

# Re Old Colony Gas Company

**D.P.U. 9866**
**March 5, 1952**

APPLICATION *for authority to issue common stock to capitalize the cost of additions, extensions, and permanent improvements; denied.*

*Security issues, § 54 — Factors affecting authorization — Interests of ratepayers and stockholders.*

1. The Commission, in passing upon an application for authority to issue common stock, must consider the interests of ratepayers as well as those of stockholders, p. 115.

*Security issues, § 95 — Kinds — Stock or bonds — Effect on rates.*

2. It is not in the public interest to authorize the issue of common stock where to do so would impose an added burden upon the ratepayer that could be avoided by the issuance of long-term debt securities, p. 115.

*Security issues, § 99 — Debt ratio — Common stock or bonds.*

3. A debt ratio of slightly under 37 per cent, compared with 63 per cent stock and surplus, was not considered excessive, p. 115.

*Security issues, § 95 — Kinds — Common stock or bonds.*

4. It was not considered reasonably necessary in the public interest for a public utility company to issue additional capital stock so long as it could finance necessary plant additions with a long-term debt issue at a considerably lower expense to the public, p. 115.

APPEARANCE: Robert H. Holt, for the petitioner.

By the DEPARTMENT: Old Colony Gas Company, pursuant to the provisions of Chap 164, § 14, of the General Laws (Ter. Ed.), as amended, filed with the Department a petition for approval of an issue of 14,000 shares of additional common capital stock, having a par value of $25 per share, at an issue price at par as fixed by the directors. The company proposes to

apply the proceeds of the issue in the aggregate amount of $350,000 for the purpose, as stated in the petition, of capitalizing the costs to the company of additions, extensions, and permanent improvements to its property. Certified copies of the votes of the stockholders authorizing the issue and of the board of directors fixing the issue price at $25 per share were attached to the petition.

A public hearing was held on January 31, 1952, and no one appeared in opposition to the petition.

Old Colony Gas Company has outstanding 39,820 shares of common capital stock and 14,180 shares of preferred capital stock, each having a par value of $25 per share, or an aggregate par value of $995,500 of common and $354,500 of preferred. No premiums have been paid in on the stock. The Eastern Gas & Fuel Associates is the sole stockholder of the company. The outstanding long-term indebtedness on December 31, 1951, was represented by $590,000 of 3 per cent coupon notes issued in 1937 and due in 1956. As of the same date the company reports short-term indebtedness payable in the amount of $350,000. The plant investment account was reported at $3,479,906.24 at December 31, 1951, and the depreciation reserve of $1,057,095.55 as of the same date was over 30.5 per cent of the depreciable property.

The Department last authorized the issue of additional securities by the company in D.P.U. 7055 dated July 26, 1943, when authority was granted to the issuance of 6,000 shares of common stock at par of $25 per share, with the proceeds thereof ($150,000) to be applied solely to the payment and cancellation of an equal amount of outstanding demand notes.

Old Colony Gas Company has filed with the Department annual schedules of additions, betterments, and retirements to its plant and property up to December 31, 1950. The accounting and engineering divisions have checked the schedules and inspected the property. The divisions report net additions to plant and property for the period January 1, 1943, to December 31, 1950, to be $736,013.01, against which permanent securities have not been authorized. Adding thereto the net additions in 1951 of $129,496.66 makes a total of capitalizable additions of $865,509.67.

That there is sufficient justification for the issue of additional permanent securities cannot be denied. Although the Department is hesitant to substitute its judgment for that of the management as to the type of security to be issued, we feel that we should weigh the relative merits of financing by stock or long-term debt. Section 13 of Chap 164 of the General Laws, as amended, permits the Department to authorize the issuance of long-term debt in an amount not exceeding the outstanding stock, premium and surplus invested in plant. As of December 31, 1951, the Old Colony Gas Company reports long-term debt in the amount of $590,000 which could be increased to a minimum of $1,350,000 under the provisions of said section. Under the present Federal income tax law if this company were to pay a 6 per cent dividend on its stock, or $1.50 a share, it would be necessary for it to earn $3.125 per share before taxes. The Old Colony Gas Company would then be required to charge its customers

rates sufficient to provide the sum of $43,750 to pay a dividend of $21,000. If, on the other hand, the company were to finance its short-term indebtedness of $350,000 with long-term debt, it is reasonable to assume that the interest rate would be about 3½ per cent or at an annual interest cost of $12,250 which is $31,500 less than the amount which would be required to pay dividends on additional stock at the rate stated. It may under normal circumstances be advisable to finance construction costs with equity securities but the high rate of taxes payable before a dividend can be paid on equity securities is of considerable importance to the rate-paying public.

[1-4] The company takes the position that it is in the best interest of the stockholders to issue more common stock while we must take into consideration the interests of the ratepayer as well as those of the stockholders. As hereinbefore stated, Eastern Gas & Fuel Associates is the sole stockholder of the company. It also is the sole holder of its long- and short-term indebtedness. Assuming that Eastern is entitled to receive a 6 per cent return on its capital investment in the Old Colony Company it would require earnings of over $300,000 before Federal income taxes if the holdings therein were represented completely by common stock capital. On a 50 per cent stock and 50 per cent debt ratio, as permitted by Chap 164, § 13, Old Colony would be required to earn only $200,000 to provide the same rate of return on equity. We cannot therefore conclude that it is in the public interest to authorize the issue of stock as herein requested. To do so would impose an added burden upon the ratepayer that could be avoided by the issuance of long-term debt securities.

We reach this conclusion with considerable reluctance as the Department has generally endeavored not to interfere with management in its decisions as to the methods used to raise additional capital funds. However we believe it is our duty, in the public interest, to keep down the cost of capital if it is evident that the financial stability of the utility will not be seriously affected. We will agree that there may be a point beyond which it would be improvident to issue additional debt securities. Common stock dividends do not have to be paid in any stated amount if earnings are inadequate to pay them and do not constitute a firm obligation. Interest payments, however, are a firm obligation in a fixed amount and the debt itself has to be paid or refunded eventually. However, in this instance the issuance of $350,000 additional long-term debt would result in a debt ratio of slightly under 37 per cent as compared to 63 per cent for stock and surplus. We do not believe that such a ratio is excessive. We are of the opinion that it is not reasonably necessary in the public interest for Old Colony Gas Company to issue additional capital stock at the present time so long as it can finance its necessary plant additionals with a long-term debt issue at a considerably lower expense to the public and we so find. Lowell Gas Light Co. v. Department of Public Utilities (1946) 319 Mass 46, 62 PUR NS 238, 64 NE2d 640; Re New Jersey Bell Teleph. Co. (1949) 80 PUR NS 97.

Accordingly, after notice, public hearing, and consideration, the Department hereby

Votes that the issue by Old Colony Gas Company of 14,000 additional shares of common capital stock, at an issue price at par of $25 per share as fixed by the directors, is not reasonably necessary for the purpose for which such issue was authorized; and it is

*Ordered:* That the petition of Old Colony Gas Company for approval of the issue of 14,000 additional shares of common capital stock be and the same hereby is denied.

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*COLORADO PUBLIC UTILITIES COMMISSION*

# Re Western Union Telegraph Company

Application No. 11475, Decision No. 38248
March 7, 1952

APPLICATION *by telegraph company for authority to abandon long-distance telephone service; granted.*

*Service, § 221 — Abandonment — Telegraph company's telephone operations.*

1. The factors to be considered by a Commission, in passing on an application by a telegraph company for authority to abandon its telephone service, are the company's financial condition, the fact that the service in question is operated at a loss, and the availability of an adequate and satisfactory substitute service, p. 124.

*Service, § 275 — Abandonment — Telephone service by telegraph company — Competition.*

2. The Commission, in considering an application by a telegraph company for authority to abandon its telephone service, is reluctant to require the company to continue the service where such a requirement would tend to encourage competition between two telephone services on a large scale, p. 124.

*Service, § 275 — Abandonment — Telegraph company's telephone service.*

3. A telegraph company's application for authority to abandon its telephone service was approved where it appeared that approval of the application would be advantageous to the general public, to the subscribers of a competing telephone company, and to the users of the abandoning company's telegraph facilities, since the competing telephone company would obtain additional revenue because of the additional use of its facilities and the users of the company's telegraph service would no longer be required to subsidize its telephone service, p. 124.

APPEARANCES: Holland and Hart, Denver, by Patrick M. Westfeldt, Denver, John H. Waters, General Counsel, The Western Union Telegraph Company, New York, New York, and William Wendt, General Solicitor, The Western Union Telegraph Company, New York, New York, for applicant;

Akolt, Campbell, Turnquist and Shepherd, Denver, by John R. Turnquist, Denver, for The Mountain States Telephone and Telegraph Company; Julius I. Ginsberg, Denver, for Goldstein Refrigerator Line, Denver, Hall Brokerage, Pueblo, Hurd Brokerage, Pueblo, Williams Produce Company, Pueblo, Union Fruit Company, Pueblo, J. G. Andrews, Pueblo, and Stine Fish and Grocery Company, Pueblo; Harold Taft King, Denver, for the Columbia Savings and Loan Association, Denver; Earl M. Scanlan, Denver, for Scanlan and Company, Denver; Carl E. Stitt, Denver, for J. A. Hogle and Company, Denver, and Macart Jones Company, Pueblo; Orville W. Charlton, Denver, for Beatrice Foods Company, Denver, Colorado Springs, and Pueblo; Ralph Sargent, Jr., Denver, for the Commission.

By the COMMISSION: This is an application by The Western Union Telegraph Company seeking authority from this Commission to abandon its long-distance intrastate telephone service in Colorado, and to cancel and withdraw its tariff Colo. P.U.C. No. 1, Schedule E–1, original pages 130 to 139, inclusive, in connection therewith.

After due notice to all interested parties, the matter was set for hearing on January 24, 1952, in the Commission's hearing room, 330 State Office building, Denver, Colorado, and was there heard and taken under advisement.

The Western Union Telegraph Company (hereinafter referred to sometimes as the "Telegraph Company") is a New York corporation, engaged in the business of communications by telegraph and cable throughout the United States and between and among points in the state of Colorado. The Telegraph Company is also engaged in the business of rendering intrastate long-distance telephone service wholly within the state of Colorado, in addition to its telegraph service. This Commission has jurisdiction over the intrastate operations of both the telegraph and telephone service rendered within the state of Colorado by the said Telegraph Company.

Prior to 1943, the Telegraph Company was not engaged in the telephone business in Colorado, but on October 7, 1943, under the authority of the Federal Communications Commission, in that Commission's report and order, reported in 10 FCC 148, the Telegraph Company acquired by merger the Postal Telegraph System. The facilities acquired by the Telegraph Company from the Postal Telegraph System consisted of both telegraph and telephone service in many states throughout the United States and in the state of Colorado, including a long-distance intrastate telephone service wholly within the state of Colorado. The instant application deals only with the said long-distance intrastate telephone service of the Postal Telegraph System acquired by the Telegraph Company in the state of Colorado.

In Re American Teleph. & Teleg. Co. Docket No. 9235, April 5, 1951, before the Federal Communications Commission, the American Telephone and Telegraph Company and certain other associated companies of the Bell System and the Western Union Telegraph Company made a joint application to the Federal Communications

Commission, asking that Commission's approval of an agreement dated July 1, 1948, between the American Telephone and Telegraph Company and the said other associated companies of the Bell System and the Western Union Telegraph Company. Said agreement provided for the transfer by the Western Union Telegraph Company of its public telephone business and certain telephone property to the Bell Companies, and also for the transfer by the Pacific Telephone and Telegraph Company and the Bell Telephone Company of Nevada of their public message telegraph business to the Western Union Telegraph Company. The agreement also provided for the payment of $2,400,000 in cash to the Western Union Telegraph Company by the American Telephone and Telegraph Company and the various associated companies of the Bell System, parties to said agreement.

The Federal Communications Commission's order in the said Docket No. 9235, *supra,* permitted the Western Union Telegraph Company to dispose of its telephone business to the Bell System, and in turn permitted the Bell System to dispose of its public message telegram service to the Western Union Telegraph Company. A copy of the findings and order of the Federal Communications Commission in its Docket No. 9235, dated April 5, 1951, *supra,* was filed as Exhibit No. 2 in the instant proceeding.

Said order of the Federal Communications Commission, however, related only to the transfer and acquisition of interstate communication facilities of the respective companies involved in said proceeding.

The application before this Commission at this time is to seek the approval by this Commission for the abandonment by the Western Union Telegraph Company of its long-distance intrastate telephone service in Colorado originally acquired by the Telegraph Company in 1943 from the Postal Telegraph System, as described hereinabove, and the cancellation and withdrawal of its tariffs in connection therewith, so that said telephone property and facilities might be transferred by the Western Union Telegraph Company to the Mountain States Telephone and Telegraph Company, one of the said associated companies of the Bell System, pursuant to the said terms of the agreement of July 1, 1948.

Exhibit No. 1, introduced at the hearing before this Commission, is a copy of the said agreement of July 1, 1948, between the Western Union Telegraph Company and the various telephone companies in the Bell System, setting forth the agreement to sell and purchase and providing for the pro rata share among the Bell System Companies of the total purchase price of $2,400,000. By the terms of said agreement, the Mountain States Telephone and Telegraph Company is to pay $130,000 as its pro rata share of the total payment of $2,400,000 by the Bell System Companies to the Western Union Telegraph Company. In return for the payment by the Mountain States Telephone and Telegraph Company of $130,000 as its pro rata share of the total payment by the Bell System Companies to the Western Union Telegraph Company under the terms of said agreement of July 1, 1948, the Western Union Telegraph Company will transfer to the Mountain

States Telephone and Telegraph Company certain telephone properties of the Western Union Telegraph Company located in the states of Idaho and Utah and the long-distance intrastate telephone service of the Telegraph Company in the state of Colorado.

Exhibit No. 5, introduced at the hearing, lists the investment and plant on an original cost basis devoted to telephone service in the state of Colorado now owned by the Western Union Telegraph Company. Under the terms of the proposed purchase and sale, only certain items of property are covered and will be transferred by the Telegraph Company to the Mountain States Telephone and Telegraph Company, consisting of central office equipment, station apparatus, drop and block wire, booths and special fittings, materials and supplies. No intercity wire plant nor intracity wire distribution plant is to be included in the transfer, since it is the intent of the Telegraph Company to continue the use of its outside plant in the furtherance and operation of its telegraph business.

The following tabulation shows the items of telephone service equipment that would be transferred by the Telegraph Company to the Mountain States Telephone and Telegraph Company as a part of the said agreement of July 1, 1948, heretofore mentioned:

| | Denver | Colo. Springs | Pueblo | La Junta | Rocky Ford | Gross Inv't | Accrued Depr. | Net Invest'd |
|---|---|---|---|---|---|---|---|---|
| Central Ofc. Equipt. | $3,863 | $1,656 | $3,180 | $533 | $268 | $9,500 | | |
| Station Apparatus | 3,751 | 1,862 | 2,030 | 487 | 280 | 8,410 | | |
| Drop & Block Wires | 1,680 | 614 | 698 | 177 | 88 | 3,257 | | |
| Booths & Spec. Fixt. | — | — | — | 150 | — | 150 | | |
| Mat'l and Supplies | | | | | | 2,110 | | |
| Total Plant and Equipment | | | | | | $23,427 | $6,757 | $16,670 |

In consideration for the transfer to the Mountain States Telephone and Telegraph Company by the Telegraph Company of the above telephone service property in Colorado of the Telegraph Company, and of the telephone properties of the Telegraph Company located in the states of Idaho and Utah, the Mountain States Telephone and Telegraph Company proposes to pay to the Western Union Telegraph Company $130,000, of which the amount of $118,000 will be chargeable to the Colorado Division of the Mountain States Telephone and Telegraph Company. Witness for the Mountain States Telephone and Telegraph Company stated that the Telephone Company will account for this transaction on its books in accordance with the Uniform System of Accounts as prescribed by this Commission for telephone companies. As a result of this accounting procedure there will be no write-up of the original cost of the telephone property acquired by the Mountain States Telephone and Telegraph Company on its books.

The plant of the Western Union Telegraph Company devoted to telephone service in Colorado consists for the most part of five switchboards, cus-

tomers' station apparatus, pole lines, wire and cable connecting the switchboards, and customers' apparatus. One switchboard is located at Denver, having a 96-line capacity, one switchboard at Colorado Springs with a 45-line capacity, one switchboard at Pueblo with 70 lines, one switchboard at Rocky Ford with 9 lines, and one switchboard at La Junta with 9 lines. The total capacity of the above-mentioned boards would allow for 237 subscribers. The service rendered at the five named points is in the nature of a toll or long-distance service with no intracity connections possible. In other words, a subscriber in Denver cannot talk with another subscriber in Denver, but can only talk to subscribers located in Colorado Springs, Pueblo, Rocky Ford, or La Junta. Each of the five points on the system can only talk to the other four points.

Exhibit No. 3 introduced at the hearing is a map showing the location of the intercity lines of the Western Union Telegraph Company and the number of telephone line pairs between the cities. This exhibit shows that between Denver and Colorado Springs there are four pairs of wires, between Colorado Springs and Pueblo three pairs, and between Pueblo and Rocky Ford one pair, and Rocky Ford and La Junta one pair. As a result of the number of pairs of wire between cities, the number of simultaneous conversations is limited. As an example, a maximum of four simultaneous calls may be made between Denver and other points, provided one of the calls is to Colorado Springs—otherwise only three simultaneous calls can be made. At Colorado Springs, only three simultaneous calls can be handled, and one of these calls would have to be to Denver—otherwise only two calls could be handled at once. At Pueblo, four simultaneous calls can be made, but one would have to be to either Rocky Ford or La Junta, and one to Denver. The other two calls would either have to be to Colorado Springs, or one to Colorado Springs and the other to Denver. Pueblo cannot make three simultaneous calls to the same point on the system. A subscriber at Rocky Ford can talk to a subscriber at La Junta or a subscriber at La Junta can talk to a subscriber at Rocky Ford, but not simultaneously. The lines between these two points will only take one call at a time. Furthermore, if Pueblo has a call for either Rocky Ford or La Junta, subscribers at these latter two points cannot talk to the rest of the system or each other. The maximum number of simultaneous calls between points on this system have definite limitations due to the limited number of circuits available for telephone service.

Exhibit No. 4 introduced at the hearing shows the Western Union Telegraph Company's toll telephone service revenue and the number of telephone calls for the years 1944 to 1951, inclusive. This exhibit is for the Telegraph Company's telephone system as a whole, in the United States, and is not limited to the intrastate telephone service of the Telegraph Company in the state of Colorado. This exhibit shows that for the years listed, 1946 was a peak year, both in revenue and number of calls made. The revenue for 1946 is shown as $624,471, with the total number of calls listed as 538,337. There has been a decline both in revenue and calls made since 1946. In

the year 1951, the revenue is shown as $165,620 and the number of calls is estimated at 189,000. This would indicate a decrease in revenue from the year 1946 to the year 1951 of approximately $459,000, and a drop in the number of calls of about 349,000.

On January 1, 1948, the Western Union Telegraph Company had 213 telephone subscribers in the state of Colorado. On January 1, 1950, the number of subscribers was 171. On January 1, 1951, subscribers had dropped to 157, and the latest count of December 1, 1951, indicates there were only 139 subscribers in Colorado. The number of subscribers for the total Western Union System was listed at 3,697 on January 1, 1948, and 1,685 on September 1, 1951.

Exhibit No. 6 introduced at the hearing by applicant shows the operating revenues and expenses for the year 1951 for the Colorado intrastate operation of the Telegraph Company's telephone business. Operating revenue is shown as $22,560, while total operating revenue deductions are listed as $32,295, showing a net loss on Colorado intrastate telephone operations in the amount of $9,735. The total revenue of $22,560 was obtained from the five cities in Colorado according to the following percentages:

| | |
|---|---|
| Denver | 50% |
| Colorado Springs | 21% |
| Pueblo | 28% |
| Rocky Ford and La Junta | 1% |

Exhibit No. 7 introduced at the hearing shows the number of calls and initial and overtime minutes of calls handled in Colorado during October, 1951. This exhibit shows that the greater portion of the traffic in Colorado is between Denver, Colorado Springs, and Pueblo, with La Junta and Rocky Ford contributing a very minor part of the total.

Exhibit No. 9 introduced at the hearing is a comparison of the telephone toll rates for the Telegraph Company, the Mountain States Telephone and Telegraph Company station-to-station, and the Mountain States Company person-to-person, as of January 1, 1952. This exhibit indicates that for the initial 3-minute call and the rate for each minute in overtime over three minutes, the Telegraph Company's rate is cheaper than the Mountain States Telephone and Telegraph Company's rate, either station-to-station or person-to-person, between Denver-Colorado Springs, Denver-Pueblo, and Colorado Springs-Pueblo, the three towns that handle the most business.

A number of the subscribers now receiving the service of the Telegraph Company's telephone system in the state of Colorado appeared at the hearing and protested the proposed abandonment of said telephone service. These subscribers offered testimony, both in regard to the type of service rendered by the Western Union Telegraph Company and their reasons for wanting Western Union to continue in the telephone business. The gist of the testimony as given by protestants was to the effect that the Western Union Telegraph Company now renders a personalized rapid service that is an asset to them in their business, and, while several stated the fact that this service was cheaper than any offered by the Mountain States Telephone and Telegraph Company, they would still want this service, even if the rates of the Western Union Telegraph Com-

pany were on a parity with the Mountain States Telephone and Telegraph Company.

It was also claimed by protestants that the Western Union Telegraph Company has discouraged the acceptance of new business, while witnesses for the Telegraph Company stated that the Telegraph Company has simply not encouraged new business. At the time of the merger between the Postal Telegraph System and the Western Union Telegraph Company in 1943 (51 PUR NS 357), the then president of the Western Union Telegraph Company stated at the hearing before the Federal Communications Commission that:

"Western Union's policy is to limit its activities to commercial telegraph service and such nontelegraph services as are consistent therewith and in the public interest.

"These do not include commercial telephone service and accordingly Western Union will endeavor to find a purchaser for the telephone service currently rendered by Postal. If such a purchaser is not found before merger, Western Union will provide this telephone service after merger until a satisfactory purchaser is found."

In view of the above statement, it is understandable that the Western Union Telegraph Company has not solicited new business. Protestants have admitted in effect that, if in order to secure new business applicant were to install new and modern equipment and increase its outside plant to take care of more subscribers, a rate increase would probably be justified. Just how many of the existing customers of the Western Union Telegraph Company would remain with it after such a rate increase is problematical in view of the fact that where rates with the Mountain States Telephone and Telegraph Company are on a parity, namely, Denver to Rocky Ford and Denver to La Junta, there are few, if any, calls placed on the Western Union Telegraph Company's system.

Protesting subscribers having the benefit of the telephone service provided by the Western Union Telegraph Company during the year 1951 stated that the telephone service during that year by the Telegraph Company was completely adequate and satisfactory, and that they, therefore, could see no reason for the abandonment of such service by the Western Union Telegraph Company. In this respect, however, it should be noted that the Western Union Telegraph Company has lost telephone subscribers in the state of Colorado over a number of years, as discussed above, and this has resulted in the Telegraph Company's rendering telephone service at a loss. Nevertheless, the decline in the number of telephone subscribers has proved beneficial service-wise to the remaining subscribers on the Western Union Telegraph Company system. The fewer telephone subscribers served by the Western Union Telegraph Company on its system in Colorado, the better service the Telegraph Company can render to its remaining subscribers. For example, Denver has a switchboard to accommodate 96 connections, and as of December 1, 1951, there were only 62 subscribers connected to this board. Obviously, the Telegraph Company has been able to provide more satisfactory telephone service to these 62 subscribers than if there were 96 subscribers connected to

this board. Likewise, on the whole system in the state of Colorado, with total possible connections of 237 subscribers on the switchboards, the number of subscribers was only 139, facilitating the customers' opportunity of obtaining ready and immediate telephone connections.

Protestants stated that it was advantageous to them to have two telephone services available to them in their respective businesses, and that they could use the Mountain States Company system to transact local business and at the same time could receive long-distance calls on the Western Union Telegraph Company's telephone system. It is apparent that all of the protestants now use the Mountain States telephone service locally, and upon occasion, they also use the telephone system of the Mountain States Company for long-distance calls. This is particularly true on Sundays and holidays, when it is desirable to reach parties at their residences. The telephone service of the Western Union Telegraph Company in Colorado does not service residences.

One protestant stated that he had five telephones in his place of business—three telephones in local service of the Mountain States Company, one long-distance telephone of the Mountain States Company, and one long-distance telephone of the Western Union Telegraph Company. Another protestant stated that he had four telephones in his place of business—three telephones of the Mountain States Company, and one telephone of the Western Union Telegraph Company. Since the question of rates was not seriously at issue, as indicated by the testimony of some of the protestants, additional telephones from the Mountain States Telephone and Telegraph Company would certainly be beneficial where local and long-distance calls are coming in simultaneously.

Several of the protestants complained that they were unable to complete calls on the Mountain States Company System fast enough to enable them to handle their business transactions promptly and satisfactorily. Several protestants spoke of delays of from fifteen minutes to one hour or more.

The Commission is cognizant of time delays on calls of the Mountain States Telephone and Telegraph Company between Denver and Colorado Springs and Denver and Pueblo in times past. However, it is now apparent that the addition of new telephone circuits between Denver and Colorado Springs, as shown on Exhibit No. 12 introduced at the hearing by the Mountain States Telephone and Telegraph Company, should improve this situation considerably as far as calls between Denver and Colorado Springs are concerned, and that the installation of three additional circuits, probably in February, 1952, between Denver and Pueblo, should materially improve the telephone service between Denver and Pueblo. This same Exhibit No. 12 shows that 13 additional circuits are planned by the Mountain States Telephone and Telegraph Company for the second quarter of 1952, between Denver and Pueblo, and that three additional circuits between Colorado Springs and Pueblo are also scheduled for the second quarter of 1952. Exhibit No. 12 also shows that there is excess message capacity available between Denver and Colorado

Springs, Denver and Pueblo, and between Colorado Springs and Pueblo at the present time over the combined average peak day messages transmitted.

[1, 2] Among the various factors to be considered by this Commission in such an application as this, where application is made to abandon an existing public utility service are: 1. The financial condition of the operating public utility; 2. If the operating condition is such that the public utility is rendering said service at a loss, whether or not a rate increase would assist the company; and 3. If abandonment is warranted, the availability of an adequate and satisfactory substitute service.

It has already been shown herein that the Western Union Telegraph Company is presently operating its telephone service in the state of Colorado at a loss. Furthermore, it is apparent from the record that the rehabilitation of the Western Union Telegraph Company's property, with an enlargement of its facilities, would necessitate a substantial rate increase not only to off-set the present operating losses, but, in addition, to provide an adequate return on the additional investment. If this Commission were to order the Telegraph Company to add to its telephone facilities and were to grant a rate increase to compensate for the items before mentioned, the Commission would then be encouraging unnecessarily competition between two utilities rendering a similar telephone service. There is no assurance to Western Union that, if its rates were set on a par with those of the Mountain States Telephone and Telegraph Company, the Western Union Telegraph Company would still not continue to lose business to the Mountain States Telephone and Telegraph Company. If the instant application involved an application by the Western Union Telegraph Company to enter initially into the field of telephone communication service in the state of Colorado, the Commission would be very reluctant to entertain such an application. For the same reason, the Commission is reluctant at this time to encourage competition between two existing telephone services on the magnitude involved herein. While some of the protestants testified that the substitute service of the Mountain States Telephone and Telegraph Company would be undesirable, it is apparent to this Commission that an adequate and satisfactory substitute telephone service is readily available to the present subscribers of the Western Union Telegraph Company. Since most of the protestants are now being rendered telephone service already by the Mountain States Telephone and Telegraph Company, they would not be deprived of any telephone service if the telephone service of the Western Union Telegraph Company should be permitted to be abandoned. Any questions as to additional telephones that might be needed by these subscribers in the course of their business can be arranged for with the Mountain States Telephone and Telegraph Company if and when the need should arise.

[3] The Commission is of the opinion that the granting of this application will be advantageous to the general public, as well as to the subscribers of the Mountain States Telephone and Telegraph Company and the users of the Western Union Telegraph

Company's telegraph facilities, since the Mountain States Telephone and Telegraph Company will obtain additional revenue because of the additional use of its telephone facilities, and the users of the Western Union Telegraph Company's telegraph service will no longer be subsidizing telephone subscribers of the Western Union Telegraph Company. All of the telephone business in the state of Colorado will be concentrated in one company, the Mountain States Telephone and Telegraph Company, and all of the telegraph business in the state of Colorado will be concentrated in one company, the Western Union Telegraph Company. This should be conducive to better communication service on the part of these companies operating in the state of Colorado.

### *Findings*

The Commission finds:

That applicant, the Western Union Telegraph Company, should be authorized to abandon its intrastate long-distance telephone service in the state of Colorado and withdraw and cancel Tariff Colo. P.U.C. No. 1, Schedule E-1, Original Pages 130 to 139, inclusive.

### Order

The Commission *orders:*

That the Western Union Telegraph Company be, and it hereby is, authorized to abandon its intrastate long-distance telephone service in the state of Colorado, and to cancel and withdraw Tariff Colo. P.U.C. No. 1, Schedule E-1, Original Pages 130 to 139, inclusive, filed with this Commission on October 24, 1943, upon not less than ten days' notice to this Commission and to its existing subscribers.

That upon the completion of the sale as per the agreement of July 1, 1948, between the American Telephone and Telegraph Company and the various associated companies of the Bell System and the Western Union Telegraph Company, the Western Union Telegraph Company shall submit in writing to this Commission the bookkeeping entries that it has made on the books of the Western Union Telegraph Company as they pertain to the sale of the Colorado telephone property involved herein. At the same time, the Mountain States Telephone and Telegraph Company shall submit to this Commission in writing the entries it has made on its books regarding the acquisition by it of the Colorado telephone property of the Western Union Telegraph Company involved herein.

That the Commission shall retain jurisdiction of the instant matter to make such further order, or orders, as may be required in the premises.

That the Western Union Telegraph Company is hereby authorized to give notice, as provided herein, of its intention to abandon its intrastate long-distance telephone service in the state of Colorado, and to cancel and withdraw its tariff in connection therewith prior to the effective date of this order, but the abandonment of said telephone service and the cancellation and withdrawal of said tariff in connection therewith shall not become effective until the effective date of this order, as herein provided, or subsequent thereto.

# Public Utilities Commission

*v.*

# A. Karl Palmer, Doing Business As Spencer Telephone Exchange

F-2352
March 28, 1952

COMPLAINT *against adequacy of telephone service; service improvements ordered.*

*Service, § 142 — Duty to serve — Financial inability.*

The financial inability or poverty of the owner of a telephone company is not a good defense for failure to discharge his public duty or his refusal to comply with a Commission order to make admittedly necessary service improvements.

APPEARANCES: John A. Engel, Attorney, Avon, representing the telephone company and Mr. Palmer; J. W. Bollinger, Platte, representing G. J. McGregor, Administrator for the estate of G. J. McGregor; Herman L. Bode, Assistant Attorney General, appearing in the public interest.

By the COMMISSION: On February 4, 1952, a formal complaint was filed with the Commission, signed by eighteen patrons and subscribers of the Spencer Telephone Exchange at Spencer, South Dakota, alleging that the service was wholly inadequate, that the patrons could not depend upon obtaining either local or outgoing calls, and that the owner of the telephone system was failing to observe his duties and obligations as a common carrier of messages as required by the laws of this state, and requesting the Commission to issue its order requiring the rendition of reasonably adequate telephone service.

The complaint was duly assigned for hearing at Spencer, South Dakota, on the fifth day of March, 1952, at which time and place the appearances above noted were made and a transcript thereof made.

The Spencer Telephone Exchange prior to October, 1948, was owned by G. J. McGregor. At that time it was purchased by A. Karl Palmer, the present owner and operator thereof. There are 171 subscribers receiving telephone service, 44 of which are located on farm lines extending into the area surrounding Spencer, leaving a total of 127 town subscribers. At the time of the purchase the telephone plant had been in operation for many years and its condition such that an unusual

amount of maintenance and repair was necessary in order to maintain it in condition to render reasonably adequate service. The present physical condition of the plant is clearly disclosed by the testimony of A. Karl Palmer, from which excerpts thereof are quoted herein: "As far as offering excuses for the condition of the plant, I am not prepared to offer any of the excuses because, as you said, it is a junk pile." In response to a question: "Does that mean, then, Mr. Palmer, what you have here is practically junk?" Answer: "That's right, it is junk." In answer to the question: "We are interested in the public having reasonably adequate and satisfactory telephone service in Spencer," Mr. Palmer stated: "That's right, but with the switchboard in the condition it is in and underground cable and outside plant in general, it is impossible to put the thing in shape, absolutely physically impossible." Concerning his purchase of the plant in 1948, Palmer further testified, "In other words, I bought a cat in a bag, is what I bought, and I admit it. When I signed the agreement with him (McGregor), he shook his head. He said, 'You'll never make it.' But I thought I would. If I hadn't had the storm, I believe I would have made the grade." Mr. Palmer's testimony also discloses that during March, 1949, as a result of a severe snow, sleet, and ice storm, the plant had only seven poles left standing in the country, with all wires down, and that while Palmer used then all of the available equipment on hand to rehabilitate the plant and invested the proceeds of his bonus obtained for service in the Navy, it has never been sufficiently reconditioned so that dependable and adequate service can be rendered to the public.

The record also shows an estimate of $80,000 of new money necessary in order to place the plant in condition to render adequate service or to put the plant in shape, and Palmer testified that he was unable personally to borrow money or to obtain funds with which to rebuild and rehabilitate the present telephone plant at Spencer.

A typical condition of the revenue and expenses of the plant was shown by reference to the month of December, 1950, in which the total income from toll messages and rentals amounted to $737.99, whereas, the expense for the month was $717.49, leaving a net of $20.05. The record also shows that Mr. Palmer has moved away from Spencer, has accepted a position as a lineman for the Scotland Telephone Exchange. The evidence establishes that he is personally unable financially to rehabilitate the plant, and up to the date of the hearing has failed and neglected to make the necessary improvements therein to render reasonably adequate service.

The statutes of South Dakota impose upon the Commission certain duties and responsibilities in a case of this character, which read as follows:

"The Public Utilities Commission shall have authority to require any common carrier doing business in this state to install any facility necessary for the safety, convenience, and accommodation of the public, including telegraph lines and instruments and operators therefor, and telephone lines and instruments."

"In addition to the regulatory powers and duties provided by Chap 52.02, the Public Utilities Commission shall

make such investigations and order such changes and betterments and improvements in telegraph or telephone lines and exchanges as may be deemed necessary for the improvement of the telegraph and telephone service and the convenience of the public."

"In addition to any penalty imposed or remedy provided in this chapter, it is further provided that if any common carrier shall wilfully continue to neglect or refuse to comply with the provisions of this chapter, or with any reasonable order or regulation of the Public Utilities Commission, such neglect or refusal shall cause a forfeiture of the franchises of such corporation, if the same shall be a domestic corporation, and if the same shall be a foreign corporation, such neglect or refusal shall cause a forfeiture of all right and privileges to transact its business within this state."

*Findings of Fact*

The record in this case clearly proves that:

1. The Spencer Telephone Exchange, owned and operated by A. Karl Palmer, is not now, nor has it been for several months last past, rendering reasonably adequate telephone service to its patrons.

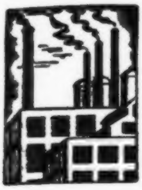
2. The physical condition of the plant and equipment has deteriorated to such an extent that it is physically impossible to render adequate telephone service in its present run-down and depleted condition.

3. A. Karl Palmer is without sufficient means financially nor does he possess the capacity to borrow funds with which to make the necessary repairs, additions, betterments, and to rehabilitate the telephone plant.

4. It is the duty of the Commission to issue its order directing and requiring said A. Karl Palmer to make the necssary improvements, additions, betterments so as to place the telephone system at Spencer in a condition capable of rendering reasonably adequate service, and that a plea of financial inability or poverty is not a good defense for failure to discharge his public duty as a common carrier and a refusal to comply with an order of this Commission to make admittedly necessary service improvements.

5. The complainants and petitioners in this case are entitled to an order of this Commission directing the rehabilitation and rebuilding of the Spencer telephone plant, and that upon failure of said A. Karl Palmer to take appropriate steps so to do, within a reasonable time, they may, upon application, request the institution of appropriate proceedings to bring about the performance by A. Karl Palmer of his duties and responsibilities as a common carrier of messages pursuant to the laws of this state.

Let an order be entered accordingly. [Order omitted herein.]



# Industrial Progress

*A digest of information on new construction by privately managed utilities; similar information relating to government owned utilities; news concerning products, supplies and services offered by manufacturers; also notices of changes in personnel.*

## Oklahoma Gas & Electric Has $15,000,000 Program Underway

OKLAHOMA GAS & ELECTRIC COMPANY has a $15,000,000 construction program under way. This is being undertaken to accommodate an estimated increase in customers of 9,000 this year, according to D. S. Kennedy, president. New customer additions during the first four months this year have run ahead of estimates.

## Donnelly Elected President Of GAMA

JAMES F. DONNELLY, an executive of the A. O. Smith Corporation, was elected president of the Gas Appliance Manufacturers Association at the opening session of the group's 17th annual meeting held recently. He succeeds Louis Ruthenburg, chairman of the board of Servel, Inc.

Other new GAMA officers elected include Sheldon Coleman, president of the Coleman Company, Wichita, Kansas, as first vice president; T. T. Arden, vice president of the Grayson Controls division of Robertshaw-Fulton Controls Company, of Lynwood, Calif., second vice president.

## More Power to America Award, New Prize Announced by EEI

A "MORE POWER TO AMERICA AWARD," for the electric utility companies that do the most to foster industrial electrification during 1952 and in each succeeding year, has been announced by the Committee on Prize Awards of the Edison Electric Institute.

Sponsored by the General Electric Company, the new award is designed to "increase the productivity of American industry by encouraging creative, broad-scale industrial electrification activity among America's electric utility operating companies, and to bring recognition to the companies and individuals making the greatest advancement in this field each year."

The first award will be made by EEI at its Sales Conference in Chicago, April 1, 1953.

## Ebasco Appointment

EBASCO SERVICES INCORPORATED, engineers, constructors and business consultants, announced that W. Douglas Lavers has joined the firm as construction manager. Mr. Lavers will be responsible for construction projects outside of the United States, the announcement stated.

## PG&E Receives Coffin Award

PACIFIC GAS AND ELECTRIC COMPANY, of San Francisco, received the Charles A. Coffin award, the electrical industry's top honor, for outstanding achievement during 1951.

Philip D. Reed, chairman of the board of the General Electric Company, made the presentation to James B. Black, president of Pacific Gas and Electric, at the Edison Electric Institute's 20th annual convention held recently in Cleveland. George M. Gadsby, president of EEI, was in charge of the special ceremony.

The award-winning company was selected

(*Continued on page* 26)

by a committee appointed by EEI, which considered 57 companies nominated to receive the award.

Selection of P. G. & E. was based on the company's desire and ability to bring adequate electric power to its area through a billion-dollar construction program, largest undertaken in electrical industry history. Begun after World War II, the program was three-quarters complete in 1951, virtually doubling the company's generating capacity in six years.

## G-E Offers Pocket Meter Guide

A HANDY, 52-page pocket guide for the selection and installation of G-E watthour and demand meters has been announced as available by the General Electric Company, Schenectady 5, New York.

Designated as GET-2376, the booklet contains simplified selection tables, descriptions of the meters, and clear-cut wiring diagrams of the various watthour and demand meters used in most systems.

## McCabe-Powers Adds To Utility Line

TWO new service and maintenance bodies, designated Series 44 and Series 44-L, have been added to the Powers-American line of public utility bodies and equipment, according to a recent announcement.

Body compartments are equipped with shelves, trays, material hooks, and parts bins. Removable shelves in each vertical compartment are padded and furnished with elastic hold-down bands. An overhead rack, with adjustable brackets, is furnished as standard equipment. Doors are of weathertight construction, fitted with flush-mounted, slam-action handles and cylinder locks, keyed alike.

Descriptive bulletins Nos. 113 and 114, may be obtained by writing the McCabe-Powers Auto Body Company, 5900 North Broadway, St. Louis 15, Missouri.

(*Continued on page* 28)

*This page is reserved under the* **MSA PLAN** *(Manufacturers Service Agreement)*

## $30,000,000 Program Planned

ARKANSAS POWER & LIGHT COMPANY plans to spend more than $30,000,000 for expansion this year, according to a recent announcement.

## AMA Elects Officers

THREE new vice presidents and eleven directors were among a slate of twenty-four business executives, representing all segments of American industry, elected to office at the recent annual business meeting of the American Management Association.

John M. Hancock, partner of Lehman Brothers will again be chairman of the board of directors; Don G. Mitchell, president of Sylvania Electric Products, Inc., New York, was elected chairman of the executive committee and James L. Madden, second vice president of Metropolitan Life Insurance Company, New York, will serve as treasurer. Lawrence A. Appley was re-elected president of the association for the fifth year and James O. Rice renamed administrative vice president and secretary. They will guide the group activities of A.M.A.'s 14,000 members in the fields of marketing, personnel, finance, manufacturing, packaging, insurance, and office administration.

The private utility industry is represented among the eleven directors of the association elected for three-year terms by Elmer Lindseth, president, Cleveland Electric Illuminating Company, Cleveland.

## Wm. Norman Becomes Partner Of Lambert & Co.

WILLIAM C. NORMAN will become a general partner of Lambert & Co., capital investment firm of 2 Wall street, New York, effective July 1st, according to an announcement by the firm. Mr. Norman has resigned as president of Northeastern Gas Transmission Company and as vice president of Tennessee Gas Transmission Company effective on the same date.

Mr. Norman, who will continue as a director of Northeastern Gas Transmission Company, has been associated with the oil and gas industry for several years and has been an officer of Tennessee Gas Transmission Company since its inception in 1943. He directed the extension of natural gas service into New England through construction of the first natural gas pipeline ever built in that area.

## Nordberg Appoints Wenzel Sales Engineer, New York Office

APPOINTMENT of Otto G. Wenzel as sales engineer in the New York office of the Heavy Machinery Division is announced by R. W. Bayerlein, vice president, Heavy Machinery Division, Nordberg Manufacturing Company, Milwaukee 1, Wisconsin. Mr. Wenzel was formerly eastern sales manager of the Diesel Engine Division of Baldwin-Lima-Hamilton Corporation.

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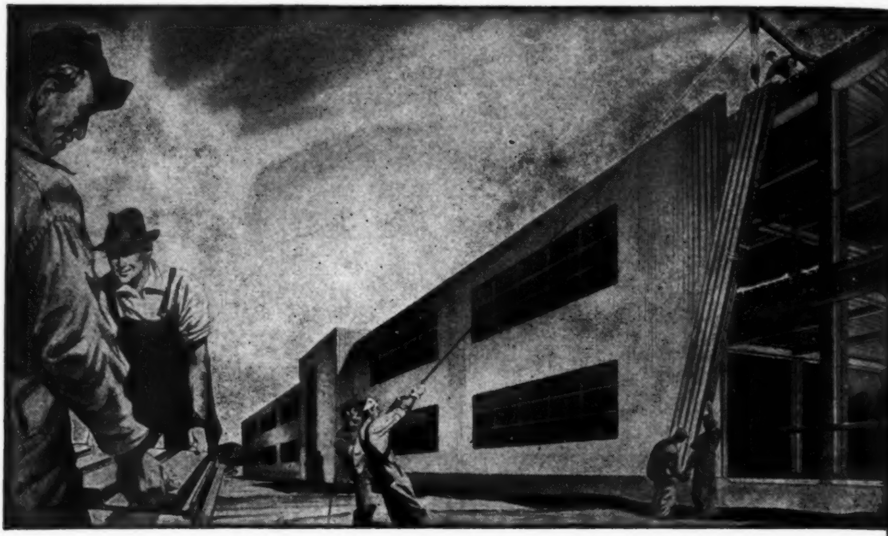



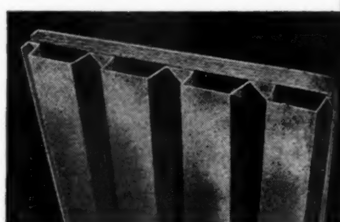



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# PROFESSIONAL DIRECTORY

• This Directory is reserved for engineers, accountants, rate experts, consultants, and others equipped to serve utilities in all matters relating to rate questions, appraisals, valuations, special reports, investigations, financing, design, and construction.



*(Professional Directory Continued on Next Page)*

## PROFESSIONAL DIRECTORY (*continued*)

## PROFESSIONAL DIRECTORY (*continued*)

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## PROFESSIONAL DIRECTORY *(continued)*

# PROFESSIONAL DIRECTORY (concluded)

# INDEX TO ADVERTISERS

*[The Fortnightly lists below the advertisers in this issue for ready reference. Their products and services cover a wide range of utility needs.]*



*Fortnightly advertisers not in this issue.

# Peak-load capacity released quickly economically by G-E switched capacitors

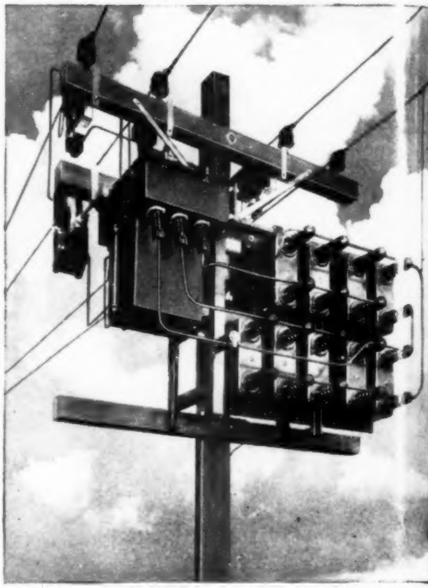
## Capacitor equipments can be supplied on short delivery . . . some at a cost of less than $6.00 per kvar . . . installed in a matter of hours

Capacitors continue to provide one of the fastest, cheapest ways to release system capacity. By raising voltage levels and reducing system current for a given load, they can free the system for the delivery of more kilowatts—at a fraction of the cost—and in a fraction of the time—it would take to add new system capacity.

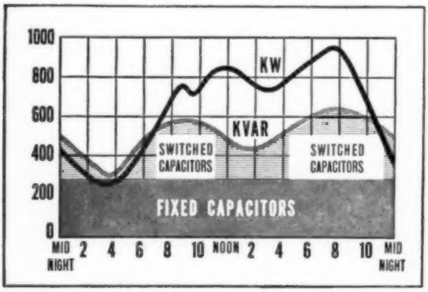
Where you have already installed a high percentage of fixed capacitors—or where your kilovar loading varies widely in any 24-hour period—it will pay you to investigate the use of switched capacitors to alleviate peak conditions.

Automatically-switched General Electric capacitors can be supplied on short delivery—for as little as $5.66 per kvar. They can be installed on your distribution feeders or at the substation—in a matter of hours. And they provide one of the least expensive methods of releasing system capacity.

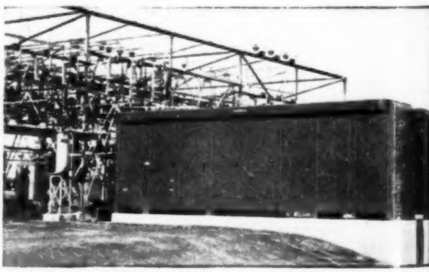
For information on how switched capacitors can help you to meet today's climbing loads, call your nearest G-E Apparatus Sales Office. Or write to Section 407-36E, *General Electric Company, Schenectady 5, New York.*



**ON DISTRIBUTION FEEDERS.** Pole-mounted G-E automatic switched capacitors are used by many utilities to bring kil supply close to load. These factory-assembled units co little as $5.66 per kvar.




**FLEXIBLE KILOVAR SUPPLY.** Where kilovar loading varies widely in any 24-hour period, G-E switched capacitors can supplement fixed capacitors in providing economical kilovars. (Ruled area shows kilovars furnished by synchronous condensers or generators.)



**AT THE SUBSTATION.** General Electric switched capa equipments can be used in large banks to supply bulk kilo Completely-enclosed equipments like this 5100-kvar, 13, volt bank installed by Metropolitan Edison Co. now as little as $7.00 per kvar.

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